

Lithuania



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Investment Profile

2001



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Foreword

Lithuania has had a successful 10-year period of transition to a market economy. The economy, political life, and everyday life of the people have all undergone fundamental changes. A consistent programme of structural reforms, accompanied by large-scale privatisation, have enabled our country to achieve substantial results in the years of transition. The aim of Lithuania's economic policy is to establish firm foundations for sustainable economic growth, to improve the business environment, tax policy and administration, and to liberalise the labour market.

Lithuania's external policies are orientated towards EU accession, NATO membership, and strengthening good relations with the neighbouring countries. With the support of all the country's political parties, concerted efforts are being made to ensure that the negotiations with the EU, which started in February 2000, will be finished before the end of 2002, and to ensure that in 2004 Lithuania will be ready to assume the responsibilities of EU membership. In 2000, Lithuania achieved its goal of completing negotiations with the WTO. This year, once the Lithuanian parliament – the Seimas – has ratified the agreement, Lithuania is expected to become a full member of the WTO.

Tight fiscal policies pursued in 2000, and maintenance of the Currency Board arrangement, supported by an agreement with the IMF, have yielded good results. Lithuania's mid-term macroeconomic stability has improved. The main macroeconomic indicators show that Lithuania's economy has recovered from the after-effects of the Russian financial crisis of 1998. In 2000, a GDP growth rate of 2.9 per cent was recorded. Considerable progress has been made in reducing the current account deficit. During the first nine months of 2000, the current account deficit decreased to 4 per cent of GDP. The decrease was achieved through a 28 per cent increase in exports during the entire year, compared to 1999.

The Government and the Bank of Lithuania's policy of maintaining the currency board arrangement, and of repegging the litas to the euro from the US dollar (according to the exchange rate of the dollar against the euro at the time of repegging) has created favourable conditions for a decrease in inflation and has strengthened investors' confidence in the Lithuanian economy. In 2000, the average annual inflation rate was 1 per cent. Structural reforms aimed at restructuring the public sector and subsequent privatisation, are being combined with a strengthening of the administrative capacity of public institutions, in order to ensure that the government can carry out its functions effectively under market economy conditions.

The process of modernisation of the legal and administrative systems is continuing, as are economic and financial reforms. A number of measures have been taken to improve budget management, and strengthen banking supervision, by implementing a firm fiscal policy and strengthening the transparency of monetary and financial measures.

In order to attract more foreign direct investments (FDI), extensive action is being taken to improve investment-related policies and business conditions, and to eliminate the remaining obstacles to business development. Cumulative net FDI from 1993 to the end of 2000 is estimated at a total of more than US\$ 2.4 billion. The long-term perspective is based on strengthening and developing the above mentioned reforms in the context of EU accession, creating a favourable atmosphere for the private sector and an attractive destination for foreign direct investments.

Jonas Lionginas

Minister of Finance and EBRD Governor for Lithuania

Introduction



Since independence in 1990, Lithuania has successfully managed its transition towards a market economy. With a consistent programme of structural reforms and comprehensive privatisation, major results have been achieved. It took the Lithuanian economy some time to recover fully from the Russian crisis of 1998, as it had substantial trade links with the CIS, but the country has been successful in reorienting its exports to new markets, notably the EU countries, and in regaining part of its CIS markets. Following a financially difficult 1999, the economy improved considerably in 2000 and GDP grew by almost 3 per cent. Lithuania started accession negotiations with the EU in 2000 and is implementing further reforms to accelerate its entry. If the government adheres to its policies to keep the fiscal and current account deficits at a low level, and to keep on track with restructuring and privatisation, the country is likely to increase economic growth and achieve EU membership within the next few years.

Autumn 2000 was characterised by a change in the political landscape. In the parliamentary elections of 8 October the coalition of Conservatives and Christian Democrats, who had been in power since 1996, was defeated. Subsequently, President Valdas Adamkus approved the cabinet of incoming prime minister Rolandas Paksas, who had already served briefly as prime minister in 1999. Mr. Paksas' centre-right Liberal Union finished second in the October elections, behind the Social Democrats, but formed a minority parliamentary bloc with the centre-left New Union-Social Liberals, which finished third, gaining control of 67 of 141 seats in parliament (the Seimas). The Peasant Party, the Polish Electoral Action party and two independents conditionally support the coalition in parliament giving it a potential majority of 73 seats. Within the programme of action for its first 100 days in office, the new coalition passed a 2001 state budget that assumes further fiscal tightening as recommended by the IMF, and pledged to accelerate EU accession negotiations.

Key reform challenges

While macroeconomic performance and external balances improved in 2000, one of the challenges was to continue fiscal prudence, necessary to maintain the fixed exchange rate regime. The new government maintained the 2001 budget deficit target at 1.4 per cent of GDP, as agreed with the IMF by the previous administration. The current understanding by both the central bank and the government on the most desirable exchange rate policy is to maintain the currency pegged to the US dollar and to repeg the litas when the dollar/euro exchange rate is at a level deemed appropriate by the authorities. A further weakening of the dollar to the euro is likely to improve Lithuania's export competitiveness and may offer the opportunity to begin considering the repegging of the currency. The most likely timing as provided by the Lithuanian authorities is to have an official announcement on repegging by July 2001, to

become effective in the first months of 2002. Another key decision stated by both the central bank and the government is to have no devaluation or revaluation of the litas at the time of the repegging.

Significant progress in large-scale privatisation has been marred by the lack of transparency in some transactions. The privatisation of the Mazeikiu Nafta oil company in particular, completed in 1999, was subject to criticism over the non-transparent conditions of the sale. However, recent disclosure of the full terms of privatisation transactions is a step in the right direction. Despite some delay, the privatisation of the remaining state-owned banks regained momentum in 2001. Through a successful global IPO in June 2000 a 25 per cent stake in the partially privatised Lithuanian Telecom was sold, raising US\$ 160.5 million.

Reform of the electric power sector is necessary to enhance efficiency and financial performance, provided the government is able to clarify the new electricity market structure before unbundling and privatising the integrated state electricity monopoly, Lietuvos Energija. In September 2000 the authorities endorsed a restructuring plan for Lietuvos Energija ahead of its privatisation. The new government decided to continue its predecessor's policy and even made the project one of the priorities in its 100-day action plan. The restructuring and privatisation process was resumed in February and the government aims to complete it by the end of 2001. There could still be some delays, but it seems unlikely that the government will face serious opposition. The electricity law was adopted in 2000 and will become effective in July 2001.

International relations

Lithuania's post-independence foreign policy has been designed to achieve integration into western structures, most importantly the EU and NATO, and to maintain amicable relations with all

the neighbouring countries. Lithuania was the first former Soviet republic to apply for NATO membership in early 1994. NATO responded by setting up the Partnership for Peace programme, which was supplemented by the US-Baltic Charter in 1998. However, none of these agreements include western security guarantees and the Baltic states were left out of the first round of NATO eastward enlargement in March 1999. In 2002 a NATO summit will determine whether to invite any new members into the alliance.

Although Poland has lobbied staunchly for Lithuania's entry, NATO does not want to alienate Russia, which remains opposed to any of the Baltic states joining NATO. Lithuania has managed to keep relations with Russia cordial, apart from some tensions that emerged in 2000 over proposals to claim compensation from Russia for the Soviet occupation. The fact that Russians make up only 8 per cent of the population facilitated the decision to grant citizenship to all of them, thereby preventing Russia from making accusations of discrimination, as in the cases of Estonia and Latvia. Relations with Poland since 1994 have focused on mutual advantages rather than differences. Lithuania has joined an extensive variety of cooperation activities with its Baltic neighbours, ranging from free trade to joint military exercises.

EU accession prospects

Despite the change of government, the twin foreign policy goals of EU and NATO membership remain unchanged, as all the main political parties support entry. A recent joint memorandum signed by all parties in the Seimas declared EU accession as a common objective. Lithuania applied for EU membership in 1995. Unlike Estonia, Lithuania was not among the central and east European countries invited to join the first wave of accession negotiations in 1997. Lithuania received the invitation in late 1999 as one of 10 countries invited for negotiations following the Helsinki summit at which a shift in the EU enlargement strategy was decided.

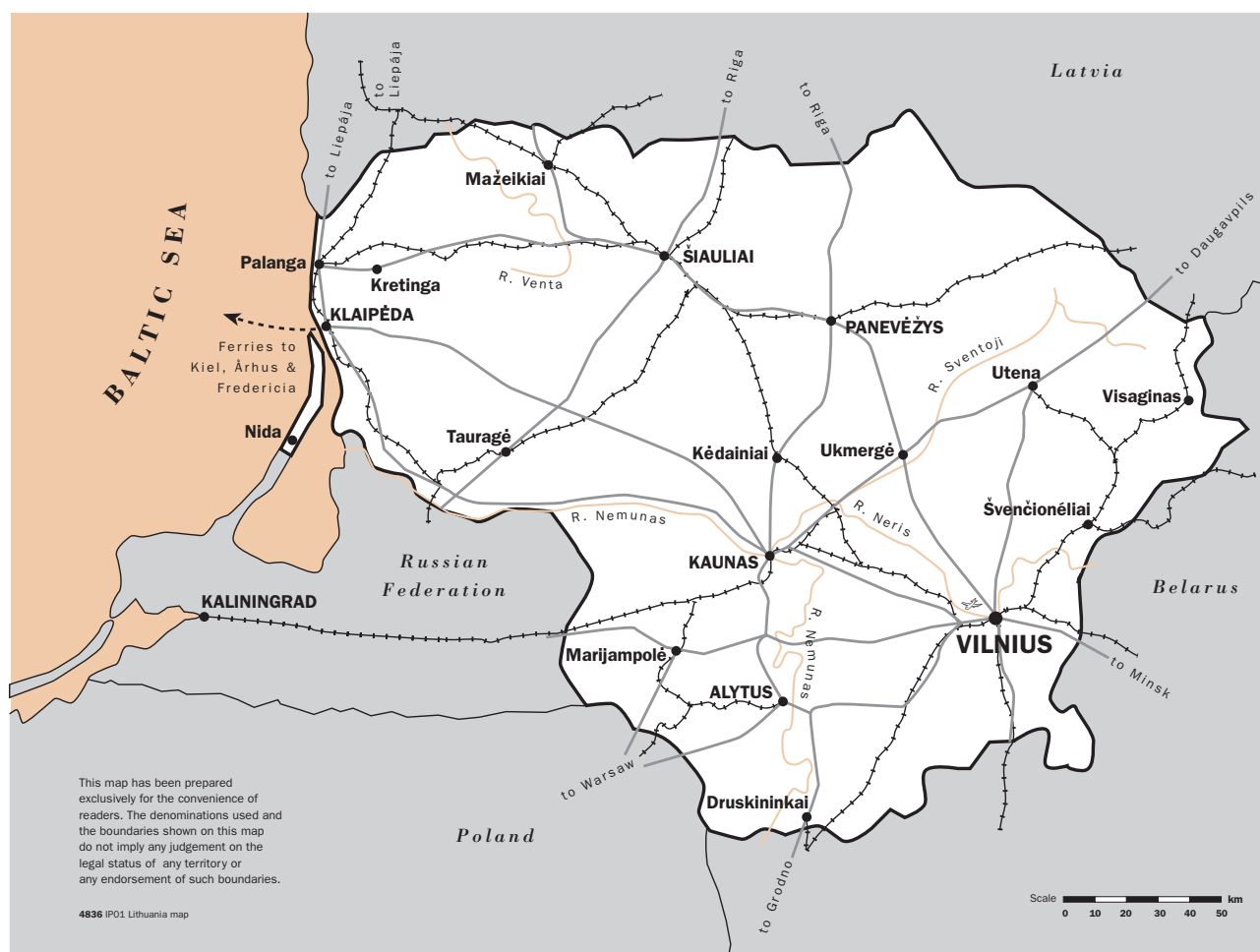
In 2000, Lithuania began pre-accession negotiations on 16 of the 31 chapters of the *acquis communautaire*, of which seven have been provisionally concluded. Negotiations on the remaining chapters are continuing in 2001, adding further impetus to structural reforms. This is likely to accelerate Lithuania's EU accession timetable. The aim is to conclude the negotiations on all the chapters in 2002 and be ready to take up EU membership obligations by 2004.

The EU's November 2000 Progress Report attests that Lithuania now fulfils two of the four accession criteria (the so-called Copenhagen criteria). It is classified as a stable democracy and, for the first time, as a "functioning market economy". However, the Commission is concerned about Lithuania's ability to implement and enforce EU rules. On the economic side, the report notes that growth has picked up since the prolonged slump that followed the Russian crisis. However, it comments that recovery has remained more fragile than in the other Baltic states, which reinforces doubts about the economy's ability to cope with external shocks. Although the Commission praised Lithuania's progress in curbing its fiscal and external balances, it notes that the medium-term sustainability of the public finances are still a source of concern.

The process of EU accession alone will constrain the government's policy choices. The coalition is determined to continue fiscal austerity, as the assumed further tightening of the deficit in the 2001 budget testifies, and has marked the restructuring and privatisation of the remaining state monopolies as a priority. The current Swedish EU presidency has provided Lithuania with new opportunities of opening accession negotiations on the remaining chapters, thereby adding further impetus to structural reforms. With improved economic growth forecast and the country firmly on track for EU accession, the year 2001 looks promising.

Ignalina

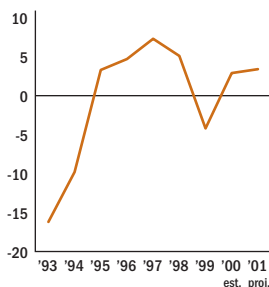
The Seimas adopted the "Law on the Decommissioning of Unit 1 at the State Enterprise of Lithuania Ignalina Nuclear Power Plant" in May 2000. The Law provides the framework for the decommissioning of Ignalina. During the donors' conference in June costs related to the Ignalina decommissioning and investment requirements for alternative power sources were discussed. The conference noted with approval the establishment of the grant-based International Decommissioning Support Fund that will support the decommissioning process. The fund will be managed by the EBRD and will include contributions from the EU and a number of bilateral donors.





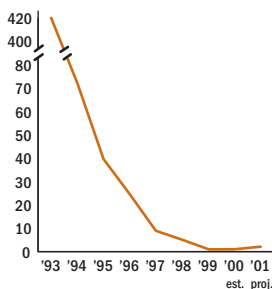
Economic summary

GDP at constant prices
% change



The Lithuanian economy recorded GDP growth in 2000 after a decline in 1999. Inflation remained at a low level and the current account deficit narrowed considerably due to strong export growth. Foreign direct investment inflows were relatively low for the second consecutive year, while revenues from privatisation were substantial. After revision upwards of the 2000 budget deficit agreed under the Stand-by agreement with the IMF, the new government is aiming for a much narrower deficit target for 2001. The peg of the litas to the strong dollar has been damaging for some exporters, but recent weakening of the dollar against the euro will improve Lithuania's competitiveness. The government has pledged to accelerate EU accession negotiations and to take up EU membership obligations by 2004.

Consumer prices
Annual average, % change



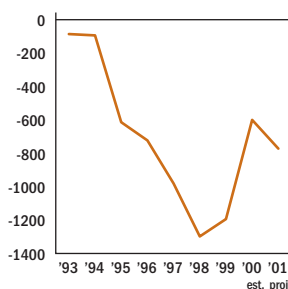
GDP growth

After a 4.2 per cent decline in 1999, in the aftermath of the Russian financial crisis, the economy has been slowly recovering in 2000. GDP growth was estimated at 2.9 per cent, primarily driven by export demand. Improvements in the transport sector and a recovery in industrial output also drove the GDP rise. Growth in 2001 is likely to improve to around 3.4 per cent, reflecting increased external demand on the back of a weakening of the currency against the euro, but a modest increase in domestic demand as a tight fiscal policy continues.

Inflation

In spite of increases in world oil prices during 2000, consumer prices have remained stable with 1.4 per cent inflation at year-end and an annual average of 1.0 per cent, reflecting weak domestic demand and the import price dampening effect of the appreciation of the litas. In 1999, inflation was even lower, at an end-year rate of 0.3 per cent and an annual average rate of 0.8 per cent. Consumer prices in 2001 are projected to rise more strongly, to reach a year-end rate of 3.5 per cent and an annual average of 2.1 per cent, reflecting continuing stronger economic growth and increasing consumer demand.

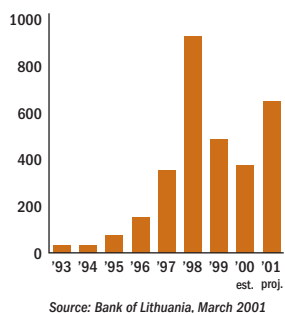
Current account
US\$ millions



Current account

During the first nine months of 2000, the current account deficit narrowed to 4 per cent of GDP compared to 11.2 per cent in 1999. This was mainly due to strong growth in exports of goods and services, a 24.3 per cent increase in US dollar terms. Over the whole of 2000, the deficit is estimated to have narrowed to 5.3 per cent from 11.2 per cent of GDP in 1999, far below the expectation at the time the Stand-by agreement with the IMF was signed, which was 9.1 per cent. The deficit in 2001 is projected to be 6.5 per cent.

Total FDI
US\$ millions, cash receipts, net



Source: Bank of Lithuania, March 2001

Foreign direct investment

Foreign direct investment (FDI) revenues in 2000 were estimated at US\$ 375 million, considerably less than the US\$ 486 million recorded in 1999. This was due to a decrease in investments related to privatisation of industrial enterprises. For 2001, due to prospective privatisation of the energy sector, FDI inflows of US\$ 650 million are projected. In the medium term Lithuania's forthcoming EU membership is likely to have a beneficial effect on FDI flows. Privatisation revenues were substantial in 2000, mainly due to the fact that the government sold a 25 per cent stake in the partially privatised Lithuanian Telecom through a global IPO raising LTL 642 million (US\$ 160.5 million) in June.

Government balance

Under the IMF agreement of March 2000 the government had committed to reduce the fiscal deficit to 2.8 per cent of GDP from 7.8 per cent in 1999. Due to disappointing budget revenues in the first seven months of the year, the government later agreed with the IMF to revise the fiscal deficit target upwards to 3.3 per cent of GDP. At the end of 2000, the new government abandoned efforts to revise the draft 2001 budget and maintained the deficit target at 1.4 per cent of GDP, as agreed with the IMF by the previous administration.

Exchange rate

As Lithuania is becoming more integrated to the EU economies, the peg of the litas (LTL) to the US dollar (US\$ 1 = LTL 4) has become an increasing burden to some exporters. Since the rouble devaluation of 1998, Lithuania has lost competitiveness vis-à-vis Russia, but also against Europe as the dollar appreciated by 26 per cent against the euro in nominal terms in 2000. In real terms, the litas appreciated by 19 per cent against the euro during 1999-2000. The current understanding by both the central bank and the new government on the most desirable exchange rate policy is to maintain the currency board arrangement and repeg the litas to the euro from the dollar without devaluation (or revaluation) when the political and economic situation is stable. The authorities are planning to announce the repegging in summer 2001, to be effective in early 2002.

EU accession

The 1999 EU Regular Report had concluded that Lithuania could be regarded as a functioning market economy and was on the way to being able to cope with competitive pressure and market forces within the Union in the medium term. In 2000 the next report stated that "Lithuania's economic situation has improved and output growth has been positive in the first half of 2000. The main factor behind this recovery is improved external demand. Nevertheless, unemployment has continued to rise, partly as a result of economic restructuring. Consumer price inflation remained particularly low, reflecting weak domestic demand and the import price dampening effect of the appreciation of the litas. The consolidation programme adopted in November 1999 led to a significant tightening of the fiscal stance, which together with the upsurge in external demand has had a positive effect on the current account."

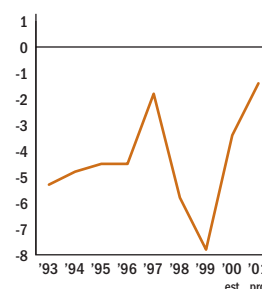
IMF agreements

The government concluded a US\$ 83 million Stand-by Agreement with the IMF in March 2000. Under the agreement, the government committed to reduce the fiscal deficit substantially in 2000 to 2.8 per cent of GDP. Given the revenue short-falls during the first seven months of 2000, the government agreed with the IMF to revise the previously agreed fiscal deficit target upwards to 3.3 per cent of GDP. According to preliminary estimates the general government fiscal deficit for 2000 was about 2.8 per cent of GDP, in line with the target set by the Stand-by Agreement. For the 2001 budget a deficit of 1.4 per cent has been agreed with the IMF.

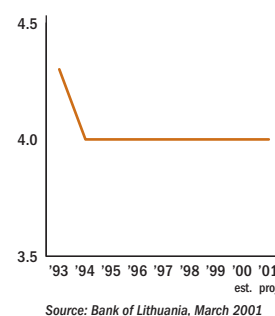
World Bank agreements

After the Stand-by agreement with the IMF had been agreed, a US\$ 100 million World Bank Structural Adjustment Loan (SAL) was released. The World Bank SAL is for restructuring of the energy and agricultural sectors, as well as reform of the pension system and private sector development. The World Bank is playing an important role in EU pre-accession preparations, notably through its analytical work and co-financing of major infrastructure investments.

General government balance
% of GDP



Exchange rate
Annual average, litas per US\$



Credit ratings**Standard & Poor's sovereign ratings, January 2001**

Local Currency			Foreign currency		
Long-term	Outlook	Short-term	Long-term	Outlook	Short-term
BBB+	Stable	A-2	BBB-	Stable	A-3

Moody's country ceilings for foreign currency ratings, January 2001

Bonds and notes		Bank deposits	
Long-term	Short-term	Long-term	Short-term
Ba1	NP	Ba2	NP

Fitch IBCA foreign currency sovereign ratings, January 2001

Long term	Short term
B-	BB+

Selected economic indicators

	1993	1994	1995	1996	1997	1998	1999	2000 est.	2001 pro.
GDP (% change)	-16.2	-9.8	3.3	4.7	7.3	5.1	-4.2	2.9	3.4
Consumer prices (annual average % change)	410.4	72.1	39.6	24.6	8.9	5.1	0.8	1.0	2.1
Current account (in US\$ millions)	-86	-94	-614	-723	-981	-1,298	-1,194	-600	-772
General government balance (% of GDP)	-5.3	-4.8	-4.5	-4.5	-1.8	-5.8	-7.8	-3.4	-1.4
Trade balance (in US\$ millions)	-155	-205	-698	-896	-1,147	-1,518	-1,405	-976	-1,196
Total FDI (in US\$ millions, cash receipts, net)	30	31	73	152	355	926	486	375	650
External debt stock (US\$ millions)	na	529	1,374	2,081	3,146	3,577	4,335	4,833	5,365
Unemployment (% of labour force)	4.4	3.8	6.1	7.1	5.9	6.4	8.4	11.5	na
Exchange rate, annual average, litas per US\$	4.3	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Gross reserves, excluding gold (end-year, US\$ millions)	350	525	757	772	1,010	1,409	1,195	1,358.6	1,683.6

Source: Bank of Lithuania, March 2001

Investment climate

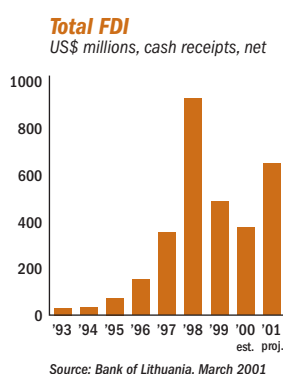


Lithuania has a favourable investment climate and one of the most liberal market economies in central Europe. With its central position in the Baltic region abutting the Russian and Polish markets, the country has been attracting increasing foreign investment, and creation of new enterprises has been dynamic. The government has accelerated the privatisation process in 2000, and the only state-enterprises left to be privatised are mainly large energy and infrastructure enterprises. Two state-owned banks have been privatised and a third one is likely to be sold soon. Legal, tax and customs systems are being improved and further harmonised according to EU directives. The forthcoming EU membership is likely to have a positive impact on FDI flows.

Foreign direct investment

Total net FDI into Lithuania in 2000 amounted to US\$ 375 million according to Bank of Lithuania estimates. This was less than in 1999 (US\$ 486 million) and considerably less than in the record year of 1998 (US\$ 926 million), but the 1998 figure was boosted by income related to the privatisation of the national telecommunications company. Total FDI in 2000 would have been higher, if some large-scale privatisations had not been delayed. The ongoing EU membership talks are likely to have a beneficial impact on FDI figures in the medium term.

Cumulative net FDI from 1993 until the end of 2000 totalled just over an estimated



US\$ 2.4 billion, according to Bank of Lithuania estimates. The manufacturing sector has attracted the highest FDI, followed by the post and communication, wholesale and retail trade and financial intermediation sectors.

The Nordic countries account for one third of total FDI into Lithuanian companies. Along with the US, Sweden and Denmark are the leading investing countries, partly because Nordic companies have made major investments in telecommunications, and also due to the sizeable participation of Nordic institutions in the Lithuanian financial sector. Other major investors are Germany and the UK.

Lithuania received more privatisation revenues in 2000 than in 1999. The bulk of the country's privatisation revenues came from the sale through a global IPO of the remaining 25 per cent stake in the partially privatised Lithuanian Telecom in June, raising LTL 642 million (US\$ 160.5 million).

Top 10 investors

Name	Country	Sector	Investment	Size of investment, US\$m
Amber Teleholdings Consortium (Telia/Sonera)	Sweden/Finland	Telecommunications	Lietuvos Telekomas (Lithuanian Telecom)	510.0 (and committed: 210.0)
Williams International	USA	Oil refining, pipelines, sea terminal	Mazeikiu Nafta	150.0 (and committed: 75.0)
Philip Morris International	USA	Tobacco products	Philip Morris Lietuva	62.0
Skandinaviska Enskilda Banken AB (SEB)	Sweden	Banking	Vilniaus Bankas	57.0
Tele Denmark A/S	Denmark/	Telecommunications	Bite GSM	49.3
Millicom East Holding B.V.	Luxembourg			
Carlsberg	Denmark	Brewing	Svyturys	45.0
Den Norske Stats Oljeselskap (Statoil)	Norway	Petroleum products	Lietuva Statoil	37.9
Danisko Sugar A/S	Denmark	Sugar productions	Sugar factories	33.8
1. Amber Mobile Teleholding	1. Sweden/Finland	Telecommunications	Omnitel	33.0
2. Motorola	2. USA			
The Coca-Cola Company	USA	Soft drinks	The Coca-Cola Bottlers Lietuva	31.5

Source: Lithuanian Development Agency, January 2001

Top 10 sources of cumulative investment, as at 1 October 2000

Country	Amount, US\$m
Denmark	389.209
USA	340.888
Sweden*	305.181
Estonia	167.126
Germany	158.940
UK	155.783
Finland*	147.195
Switzerland	112.327
Norway	101.604
Luxembourg	83.333

*According to OECD methodology the Lithuanian Department of Statistics does not include in the total FDI figure US\$ 350 million paid by Amber Teleholding Consortium (Telia/Sonera)
Source: Lithuanian Department of Statistics, December 2000

Investment policy and incentives

Consecutive Lithuanian governments have shown a solid commitment to market economics and have realised the importance of foreign investments in the transition process. As a result, Lithuania has succeeded in developing the stable foundations of a business-friendly and opportunity-filled economy, geared towards sustained long-term growth. The private sector now produces about 80 per cent of GDP. The main laws relevant to foreign investment include the Law on Foreign Capital Investment in the Republic of Lithuania and the Law on Investment in the Republic of Lithuania, which regulates the activities of both foreign and local investors.

The government has continued to take effective measures for improving the business climate, reducing bureaucracy and streamlining administrative procedures. In April 2000, two commissions were set up for implementing further measures: the "Sunset Commission" for identifying overlapping and redundant administrative functions, and the "Sunrise Commission" (with full participation of the business community) for speeding up the implementation of measures to streamline the functions and procedures dealing with business and economic matters. Preparations for joining the EU are bringing harmonisation of laws and regulations in line with EU standards and practices.

Foreign investors enjoy equal rights with domestic investors. There is a full legal framework for private enterprises, which is largely in conformity with the EU and is being further streamlined to meet EU directives. Foreigners can establish

an enterprise or acquire shares in an existing enterprise, foreign enterprises are entitled to establish subsidiaries as legal entities, or to open representative offices that are not legal entities and do not have the right to engage in independent commercial activities. Foreign investment is permitted in all fields of activity, with the exception of security and state defence, narcotics, and lottery. Licences are required in certain sectors.

Repatriation of profits derived from currency earnings (in both foreign and local currency) is not restricted. There are guaranteed rights to withdraw profits, royalties and interest in convertible currencies. Property is protected from expropriation. It can only be expropriated in extraordinary circumstances with prompt compensation at market value in convertible currency.

A new Company Law took effect from 1 January 2001, which requires companies to change their Articles of Association and re-register them within 24 months, i.e. before 1 January 2003. Among a number of other amendments under the new law, the maximum number of shareholders of private companies was lowered from 500 to 100, and the minimum authorised capital of a public company was increased from LTL 100,000 (US\$ 25,000) to LTL 150,000 (US\$ 37,500). If the authorised capital is less than the new required minimum, it must be increased within 24 months.

The new Civil Code, which will come into effect on 1 July 2001, contains six volumes including the Property Law, which establishes the concept and classification of property and defines rights *in rem*: disposal, ownership, trust, servitude, usufruct, right to pledge, long-term lease, mortgage, pledge, detention of property, etc. It also regulates the rules on administration of other persons' property and registration of property, rights *in rem* and legal facts.

The Fraser Institute (Canada) recently rated Lithuania's economy as one of the most liberal in central Europe. According to the evaluation of 27 post-communist countries made by Wall Street Journal Europe in January 2000, based on 10 criteria, Lithuania was ranked among the first countries together with Poland, Hungary and the Czech Republic.

Free Economic Zones

Lithuania is continuing to enhance its appeal to foreign investors through the development of a network of Free Economic Zones (FEZ) and Industrial Parks set up at key transport and industrial centres: Klaipeda, Utena, and Kaisiadorys. These three cities were chosen for their blend of modern infrastructure, well-developed industrial

bases and experienced labour force. Kaunas FEZ is in the process of implementation. FEZ incentives include:

- For investments over US\$ 1 million a corporate tax holiday for the first five years and a 50 per cent tax reduction for the following 10 years at an actual rate of 12 per cent.
- For investments under US\$ 1 million a corporate tax reduction of 80 per cent for the first five years at an actual rate of 4.8 per cent and a 50 per cent tax reduction for the following 5 years at an actual rate of 14.5 per cent.
- No customs duties, no VAT and excise taxes, no road and real estate taxes, withholding tax exemptions for repatriated profits (in the case of dividends, dividends paid by FEZ enterprises are taxed under the general procedure; in the case of other deductions on transferable profits, when dividends on which the tax has been paid are transferred, no other taxes are applicable either to FEZ or other enterprises).
- Streamlined and simplified customs and administrative procedures.
- The same legal guarantees for companies located inside a FEZ as for those outside.
- Special write-offs for investments and other expenses on long term assets and new technologies.

The Lithuanian Development Agency

The Lithuanian Development Agency (LDA), set up in 1995, supplies information, services and expertise tailored to investors' needs.

The LDA has three departments:

- The Investment Department develops and implements investment projects, organises seminars on investment opportunities, provides business and commercial information and assists those wishing to set up business in Lithuania.
- The Export Department supplies local companies with information about foreign markets, trade regulations and customs. It also assists in finding business partners and furnishes information about participation in international trade fairs and exhibitions.
- The Information and Public Relations Department provides information relating to the business and economic environment in Lithuania.

The LDA has four representative offices, in Germany (Frankfurt, Hahn), Russia (St Petersburg) and Argentina (Buenos Aires). These offices organise seminars and conferences on investment opportunities in Lithuania and supply foreign investors with information on the legal requirements for setting up a business in Lithuania. The LDA also publishes information and promotion booklets, fact sheets and pamphlets.

Lithuanian Development Agency

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The US Senate on 18 October 2000 approved a **bilateral investment treaty** with Lithuania. Lithuania had already ratified the treaty. Bilateral investment treaties, which provide companies with the right to invest in most sectors on terms no less favourable than domestic or other investors, allow investors, among other things, to freely transfer capital, profits, and royalties, obtain access to international arbitration, and enjoy internationally recognised standards for expropriation and compensation. Lithuania now has bilateral agreements with 30 countries.

Privatisation and restructuring

The privatisation process is nearing completion. Only the infrastructure and energy sectors are left to be privatised. Recently, the government has privatised a number of large-scale enterprises to foreign strategic investors. The biggest privatisation was the sale in 1999 of a 33 per cent stake in the Mazeikiu Nafta (MN) oil company to strategic investor Williams International (US) for US\$ 150 million (US\$ 75 million in cash to the company and US\$ 75 million by a promissory note payable in 2002). The privatisation of MN, completed in 2000, was subject to criticism over the non-transparent conditions of the sale. (See *Major sectors of the economy: Oil refining* below.)

In June 2000, a 25 per cent stake in the partially privatised Lithuanian Telecom (LT) was sold through a global IPO raising LTL 642 million (US\$ 160.5 million) despite the increasingly volatile market in technology stocks. This sale leaves the state with a 10 per cent residual holding. The government has also privatised through an international tender an 81 per cent stake in the oil exploration and production company, Geonafta, to a Polish-Swiss-Lithuanian consortium, Naftos Gavyba, for LTL 52 million (US\$ 13 million). The tender for the privatisation of shipping company LISCO was awarded to the Dutch based consortium SPC B.B. Bredo B.V. in July, but the transaction was held up by disagreements on the details and the negotiations are being continued with only one partner of the consortium, DFDS (Denmark). (See *Major sectors of the economy: Transport* below.)

An extensive bank privatisation programme has been under way and partly successful at the end of 2000 and early 2001. Estonian (Swedish owned) Hansapank was declared a leading bidder for the acquisition of the Lithuanian Savings Bank (Lietuvos Taupomasis Bankas, LTB). Financial group Sampo-Leonia (Finland) won the public tender for 100 per cent of the small state-owned Development Bank and this sale has already been completed. A second effort to privatise the Lithuanian Agricultural Bank (Lietuvos Zemes Ukio Bankas, LZUB) failed when the final bidder withdrew. Several banks, including Norddeutsche Landesbank (Germany) have expressed interest in buying a stake in LZUB when the government launches the third tender. (See *Financial sector* below.)

Markets and trade

Germany remains Lithuania's largest trading partner, accounting for about 16 per cent of both exports and imports. Latvia is the biggest export market for Lithuanian products, while Russia is the major source country for Lithuanian imports, mainly oil and gas. Mineral products were the main import commodity (24.0 per cent) as well as export commodity (21.3) in the first three quarters of 2000. Other main trading products were machinery and electrical equipment (15.0 per cent of imports, 10.6 per cent of exports) and textiles (9.5 per cent of imports, 18.8 per cent of exports).

Lithuania experienced a continuing export boom in 2000, an increase of 28.1 per cent over 1999 in US dollar terms. The Russian crisis had a positive effect, and exports to the EU have been growing faster than imports. There were good export opportunities to the Kaliningrad area and onward to mainland Russia, especially for the food sector. Exports to Russia in general have been picking up. Russian demand has been growing, while domestic demand has remained sluggish. Growth in foreign trade was mainly due to growing exports to the EU. Lithuanian exports to the EU in 2000 (year on year) increased by 22 per cent, accounting for 11 per cent of total export growth. Export growth to Russia was 29 per cent, but accounted for only 2 per cent of the total export growth.

Lithuania has been re-exporting Russian oil via the Mazeikiu Nafta complex. Mazeikiu is a very large company and heavily tips the balance of foreign trade. Oil imports and exports are paid for in US dollars, so this trade has not been affected by the Litass-US\$ peg and the low Euro (see *Economic summary: Exchange rate* above). Lithuania now exports crude oil. Mazeikiu Nafta had agreements with Lukoil (Russia) for January 2001 to ship 80,000 bbl/d of crude oil. In addition, in the

summer of 2000, Mazeikiu Nafta signed a five-year agreement with Russian oil major Yukos to export an additional 80,000 bbl/d of crude via its Butinge terminal.

Import tariffs on agricultural products were increased substantially at the end of 1998 in response to the Russian crisis. In addition, export subsidies were introduced in order to protect farmers who were in danger of losing their Russian market. These measures complicated WTO accession negotiations, but by May 2000, WTO negotiating members had broadly agreed to a Lithuanian proposal to gradually liberalise the agricultural sector over two to three years, and in the IMF Stand-by Agreement, the government committed to bring back tariff levels by November 2000, which it did.

Lithuania wrapped up negotiations on the terms of its accession to the WTO on 2 October 2000 after agreeing to demands from the US and the Cairns Group of agricultural exporting nations to curb its farm subsidy programme. Lithuania's accession protocol and working party report were formally adopted at a meeting of the WTO's ruling General

Imports and exports by country, January-September 2000

Country	US\$m		% of total	
	Exports	Imports	Exports	Imports
Total	2,847.9	3,941	100	100
EU	1,361.4	1,717.1	47.8	43.6
CIS	457.2	1,270.0	16.1	32.2
CEFTA	200.0	329.1	7.0	8.4
EFTA	79.5	66.3	2.8	1.7
Latvia	437.2	68.3	15.4	1.7
Germany	412.3	583.9	14.5	14.8
UK	201.5	195.9	7.1	5.0
Russia	185.6	1,103.2	6.5	28.0
Poland	154.0	206.1	5.4	5.2
Denmark	143.0	127.1	5.0	3.2
Ukraine	137.9	57.1	4.8	1.4
Netherlands	135.2	88.9	4.7	2.3
USA	129.8	94.4	4.6	2.4
France	129.6	172.2	4.6	2.4
Sweden	124.8	136.5	4.4	3.5
Belarus	80.4	69.3	2.8	1.8
Italy	68.8	138.6	2.4	3.5
Estonia	56.5	46.6	2.0	1.2
Belgium	45.9	78.2	1.6	2.0
Other	405.6	774.6	14.2	19.6

Source: Lithuanian Department of Statistics, Foreign Trade Statistics Division, January 2001

Exports and imports by commodity, January-September 2000

Commodity sector	Imports		Exports	
	US\$m	%	US\$m	%
Mineral products	946.970	24.0	607.319	21.3
Machinery/electrical equipment	589.415	15.0	300.949	10.6
Textiles	373.608	9.5	536.621	18.8
Chemical products	371.542	9.4	217.898	7.7
Transport means	338.139	8.6	195.665	6.9
Plastics and rubber	214.875	5.5	89.716	3.1
Base metal (products)	206.303	5.2	123.083	4.3
Prepared food products	158.041	4.0	114.437	4.0
Vegetable products	135.109	3.4	58.769	2.1
Paper and pulp products	129.388	3.3	43.757	1.5
Live animal & animal products	92.257	2.3	144.587	5.1

Source: Lithuanian Department of Statistics, January 2001

Council held on 6-7 December. Following six years of lengthy negotiations, Lithuania was finally admitted to the WTO. Lithuania will take its seat at the WTO 30 days after notifying the WTO Secretariat that it has ratified its accession agreements. Lithuanian officials told the working party that they expected ratification to be completed by 1 May 2001.

An agreement between Estonia, Latvia and Lithuania on a uniform transit procedure took effect on 1 January 2001. It introduced uniform customs requirements for cargo in transit, so that different documents do not have to be produced and different procedures followed in each Baltic state.

Taxation and social expenditure

A flat **income tax** rate of 33 per cent is applied. Rates of 10, 20 and 35 per cent apply to second jobs.

From 1 January 2000, the **corporate profit tax** rate was cut from 29 to 24 per cent in an effort to stimulate the economy in the aftermath of the Russian crisis. Earlier in 1999, the previous government had abandoned a plan to eliminate the tax entirely but had pledged to reduce it. There is a zero taxation rate on reinvested profits.

The standard **VAT** rate is 18 per cent. Exported goods and services provided beyond the borders of Lithuania are exempted. In September 2000 the Lithuanian government approved an amendment to the VAT Law under which zero VAT would be charged on services rendered to foreign businesses in Lithuania. The amendment was approved by the Seimas on 17 October 2000, the last day the old Seimas was in office, and came into effect from 1 January 2001.

Employers are subject to **social insurance tax** at a rate of 31 per cent of the payroll. Employees pay 3 per cent. However, the funding gap of the Social Security Fund (SODRA), which has been increasing in recent years, reached 1.3 per cent of GDP in 1999. As a short-term measure to close this gap, the government increased the social security tax from 31 per cent of wages to 34 per cent in 2000. SODRA ran a budget deficit of LTL 250 million (US\$ 62.50 million) in 2000.

Under the Tax Administration Law, an investor making an investment of not less than LTL 200 million (US\$ 50 million) over three years, creating at least 300 jobs or using local technology or raw materials, will be exempt from increases in the rates of direct taxes for five years from the date when the investment reaches LTL 200 million, possibly extended to 10 years, instead of an entitlement to tax benefits. Such agreements are made with both local and foreign investors.

The new government has promised a number of tax cuts to stimulate the economy, including removal of capital gains tax on share transactions to encourage stock market investments. In order to facilitate acquisition of housing, the government has decided that interest payment on housing acquisition will be compensated. Such compensations will be allocated within the state budget.

In June 1999, parliament approved the law on pension funds, which came into force in January 2000. The law establishes the legal foundations for private voluntary pension funds and will pave the way for the eventual establishment of a multi-pillar pension system as indicated in government proposals issued in May 2000.



Major sectors of the economy

As in other advanced transition economies, the service sector accounts for by far the largest part of GDP. Lithuania is an increasingly important transit hub for east-west trade and Klaipeda is a major multipurpose port, receiving considerable foreign investment inflows. The financial sector is further consolidating and increasingly attracting foreign investment. Industry accounts for about 20 per cent of GDP, with food processing as the largest sub-sector, followed by textiles. The food industry stabilised and the textile sector performed well in 2000. Industrial enterprises have regained part of their CIS market and further reoriented their exports towards the EU. The contribution of agriculture to the GDP has decreased sharply since independence and now accounts for less than 8 per cent.

Food processing

The food processing sector, which makes up the largest percentage, about one-fifth, of total manufacturing output, stabilised in 2000 after a difficult year in 1999. The dairy and meat sectors have regained a part of their traditional Russian market that was lost after the financial crisis. More companies are now acquiring EU export certificates. The brewing sector, which has been very successful in recent years and was not hit by the Russian crisis, has been further consolidated and is largely in foreign hands.

Brewing

The Lithuanian beer market grew by 10.7 per cent in the first nine months of 2000, but slowed down in the last quarter. The three dominant brands are Utenos Alus, Kalnapilis and Svyturis. The biggest brewery, Utenos Alus (Utena Beer), is owned by Baltic Beverages Holding (BBH), a joint venture of Swedish-Norwegian Pripps-Ringnes and Hartwall from Finland. Norway's Orkla, which owns half the shares in BBH, in May 2000 announced a merger with Carlsberg Breweries (Denmark), which also owns one-fifth of Hartwall. Kalnapilis, Lithuania's second largest and the Baltic republics' most modern brewery, is also owned by BBH, and Svyturis, the third largest, is 57.7 per cent owned by Carlsberg. Through the merger with Orkla, Carlsberg acquired Utenos Alus and Kalnapilis, as well as Utenos Gerimai (Utena Beverages) and Jungtinis Alaus Centras (United Beer Centre).

Carlsberg addressed the Lithuanian Competition Council with the request to allow it to merge the three largest breweries. However, as the merger between Orkla and Carlsberg would mean that Carlsberg would occupy about 70 per cent of the Lithuanian beer market, amounting to the establishment of a virtual monopoly, in November 2000 the Competition Council demanded that Carlsberg sell one of its three brewery holdings to a competitor. Until one brewery was sold, Carlsberg would not be allowed to use the distribution company owned by BBH.

BBH will dispose of its 87 per cent in Kalnapilis.

Kalnapilis and Utenos Alus have earmarked US\$ 3 million and US\$ 1.5 million respectively in total investments for 2001. Kalnapilis will put half of the money into production and the other half into the sales system.

Ragutis Brewery is Lithuania's fifth largest brewer. A. Le Coq, the Estonian subsidiary of Olvi (Finland) has 49.98 per cent of the company and plans to buy all remaining stakes. Olvi is investing US\$ 1.7 million in the construction of a new production warehouse, introduction of new bottles and marketing. Ragutis plans to introduce a new filling line in 2001 as well, which will require additional investments. Due to the investments, Ragutis reported a loss in 2000. Olvi is investing a total of US\$ 6.8 million in companies it controls in the three Baltic states.

Dairy

The dairy sector has regained a considerable part of its traditional Russian market and most large dairies now have certificates to export to the EU. Consolidation in the dairy sector is ongoing. Lithuania's dairies successfully increased their cheese production in 2000. Cheese is now exported to several countries including the US. In 2001 Rosiskio Suris, Lithuania's largest dairy producer, even launched a joint cheese production project in the Leningrad region of Russia.

In 1999 the EBRD invested € 11.5 million in the expansion and modernisation of Rosiskio Suris, which is well-established in the US, Russian and domestic markets. It enabled the company to tackle the environmental problem of waste water from milk processing, which contained high levels of organic pollutants, particularly whey. The company investigated alternative solutions, including the construction of a new waste-water treatment plant and the separation of the waste liquors in order to recover lactose for sale. Both of these elements were completed in the beginning of 2001. The EBRD holds a 32 per cent stake in the company.

Meat processing

Lithuania has six large and 20 medium-sized meat processing companies. In addition, there are more than 200 smaller producers selling meat at local markets and representing strong competition for the large processors. Most meat processors cannot export to the EU as their operations do not yet meet the required sanitary and hygiene standards, with deficiencies primarily at the slaughterhouse stage. The first EU export certificate to a Lithuanian meat company was granted in 2000 to the company Mazeikiu. The sector is gradually regaining part of its core Russian market. Lithuanian beef, poultry and sub-products exports grew considerably in 2000. Pork exports, however, declined by more than 40 per cent.

Agriculture

Agriculture's share of GDP has rapidly declined from 28 per cent at the beginning of the 1990s to less than 8 per cent at the end, yet still representing the largest agricultural sector in the Baltic states. The sector ranks second in terms of employment, with almost 30 per cent of the total workforce. The number of agricultural companies, still more than 1,400, is steadily declining. There are almost 3.5 million hectares of agricultural land, of which less than a third is privately owned by the farmers and the rest is rented from the state or individual owners. However, the market for agricultural land is not very active. Family farms occupy 44 per cent of agricultural land. Eighty-two per cent of Lithuanian farmers are involved in mixed production, while only 12 per cent specialise in raising crops. Lithuania's most important agricultural products are dairy and meat.

As an official EU applicant, Lithuania is to receive € 208.803 million pre-accession aid from the EU SAPARD (Special Accession Programme for Agriculture and Rural Development) fund from 2000 until 2006. Earlier, Lithuania received US\$ 30 million from the World Bank for a Private Agriculture Development Project. Regarding SAPARD, the Lithuanian Rural Development Plan got a favourable opinion in the STAR Committee (EC Management Committee on Agricultural Structures and Rural Development) in October 2000.

The plan, approved by the European Commission at the end of the year, foresees the following priority measures for agriculture and rural development: investments in agricultural holdings (47 per cent of the EC funds), improvement of processing and marketing of agricultural and fisheries products (21 per cent), development and diversification of economic activities, providing for multiple activities and alternative income (8 per cent), improvement of rural infrastructures

(15 per cent), afforestation of agricultural land and improvement of forestry infrastructure (4 per cent), introduction of environmentally friendly agricultural methods (1 per cent), provision of vocational training (2 per cent), and provision of technical assistance (2 per cent).

The average annual expenditure will amount to € 76.8 million during the period 2000-2006, of which € 29.8 million Community contribution (at 1999 prices). The National Paying Agency under the Ministry of Agriculture was established in November 1999 and preparations for its accreditation as the SAPARD Agency are underway. For the programme and financial management of SAPARD, a different system will apply which reflects the EAGGF (European Agriculture Guidance and Guarantee Fund) rules and is based on a fully decentralised approach through an accredited paying and implementing agency.

Lifosa

In September 2000 the EBRD made a loan of US\$ 30 million to Lifosa, a manufacturer of phosphate-based fertilisers. A further US\$ 65 million is being financed by the IFC, with each IFI syndicating US\$ 10 million of its loan to commercial participants. The proceeds will be used to improve the company's competitiveness and efficiency by removing bottlenecks in the production process, and to improve logistics by developing an import/export terminal for raw materials and finished products at Klaipeda Port. Part of the financing will be used to refinance Lifosa's short- and medium-term debt facilities.

Lifosa is one of the largest private sector companies in Lithuania, the fifth largest in terms of revenues and the third largest in terms of exports. It employs 1,400 people and since privatisation in 1996 has greatly increased its capacity and output, as well as its profits. Lifosa has a global strategic partnership with major US agribusiness producer Cargill, which is also a minority shareholder. This project has the benefits of demonstrating to other Lithuanian companies the advantages of such a partnership, which is bringing Lifosa not only investment but also new technical and managerial skills and a higher international profile.

Electronics

Enterprises in the electronics sector are highly export-oriented, exporting 70-80 per cent of their production, with EU countries representing the main market. With the help of foreign participation and capital, Lithuanian electronics companies have been acquiring increasingly strong positions in domestic, CIS and western markets. Major foreign investors include

Siemens (Germany), Samsung (South Korea), Farimex (Switzerland), Philips (Netherlands), and a number of electronics companies from the Nordic countries.

Vilniaus Vingis, one of the largest electronics firms, produces parts for television sets and monitors. Since its privatisation in 1994, Vilniaus Vingis has efficiently developed new competitive products and switched to western markets. The company designs and produces deflection yokes, used in a wide range of colour television tubes from 14" to 29", split transformers and technological equipment. Ekranas, the Lithuanian TV-tube producer, is one of the company's major clients. Vilniaus Vingis's sales surged 1.6 times in the first 10 months of 2000, compared with the same period in 1999. It sold 39 per cent of production on the domestic market, while some 57 per cent was exported. Philips, Samsung and Thomson (France) are among the major buyers of the company's production.

Ekranas, based in Panevezys, is the largest electronics company in Lithuania and the only TV-tube producer in the Baltics. Ekranas has technical support agreements with some leading international technology developers in key areas of its operations, which have been facilitating its technical restructuring. After successfully defending itself against alleged dumping claims brought by Philips in the EU, Ekranas performed extremely well in 2000 and increased its profit in the first 10 months 21-fold compared with the same period in 1999. In October 2000, Ekranas signed a long-term agreement with electronics producer Toshiba (Japan) to create a new product, the 21-inch "flatrone" picture tube for flat screen televisions. The new technological line should start operating at full capacity in 2003, and Toshiba is expected to become a permanent buyer of Ekranas's glass components by then. The agreement is important both for Ekranas and for Vilniaus Vingis, Ekranas's major partner. The project will cost US\$ 35 million and is being financed with the company's own equity and foreign bank loans. Ekranas plans to have invested US\$ 100 million in new technologies by 2004.

Baltijos Automobiliu Technika (BAT), based in the port of Klaipeda, is an automobile component subsidiary of Siemens (Germany) which produces electrical components for Renault cars. Siemens is investing US\$ 8.75 million in local wire-harness production. US\$ 5 million is invested to build new facilities next to the existing premises and production will be at full capacity by 2003. This will enable BAT to boost its output to 2,800 wiring sets for Renault Megane cars daily.

BAT now employs 1,400 people and plans to create about a 1,000 new jobs. Siemens is extending production in Lithuania and will transfer parts of its business from Portugal to Klaipeda in October 2001.

Light industry

Light industry (textiles, clothes and leather) accounts for about 16 per cent of Lithuania's industrial production, the third item after food and refined petroleum products, and makes up almost a quarter of the country's exports, representing one of the biggest export items. The sector has 60 large factories (with more than 200 employees) and more than 370 SMEs. Over 80 per cent of production are exported, notably to the EU. The EU percentage is likely to increase further as quotas are being lifted under free trade agreements. Several EU companies have moved their production to Lithuania. Textile and clothing group Marzotto (Italy), for example, is moving two-thirds of its textile operations to Lithuania to take advantage of lower labour costs. The sector generally performed well in 2000, although the US dollar peg of the litas has been causing some damage (see *Economic summary: Exchange rate* above) in this very competitive market, where competition from Asian countries is growing.

Most major FDI in the textile sector has been made by German, Italian and Austrian companies. Calwer Decken und Tuchfabriken (Germany), together with the IFC and German investment fund DEG has invested about US\$ 25 million in Liteksas & Calwer (Liteks), one of the major textile producers. Originally, Liteks was majority owned by Calwer Decken und Tuchfabriken, but the strategic investor went into bankruptcy, and the IFC and DEG took over its stake in 1999. Liteks underwent some difficult times in that period, but has now been successfully restructured and is performing well again. Alytaus Textile is 63.2 per cent owned by Tolaram Group (Singapore), which is committed to investing US\$ 60 million in a modernisation programme over a period of five years (1998-2003). Alytaus Tekstile is reorienting its production to household textiles and work clothing.

Drobe, one of Lithuania's largest textile and wool companies, exports 95 per cent of its production, mainly to western Europe. An investment project to revitalise Drobe involved privatisation, restructuring and modernisation of manufacturing facilities, and consolidation of its operations from four production sites to two. The total investment amounted to US\$ 21.3 million, US\$ 4.8 million of which paid for the state's 68.39 per cent stake in the

company (initially bought by Finnish investment fund manager CapMan), while the rest is being used to revamp and modernise the plant. At least US\$ 10 million is being invested in technology to make Drobe the first textile company in the Baltics to have a fully computerised production line.

The project was financed by the EBRD, CapMan (through the Finn Venture V and IV Funds which it manages), the IFC and Vilniaus Bankas. In June 2000 Drobe launched its reorganisation, which meant the liquidation of the Vieciunai spinning plant and the Silute weaving plant. In October 2000, CapMan sold part of the shares to the two IFIs, who in this way made a further equity contribution to the firm. CapMan now holds 41 per cent of shares in Drobe, the EBRD 19.99 per cent, the IFC 7 per cent, and the employees 32 per cent. CapMan has committed to invest no less than US\$ 11.36 million in Drobe within four years. Investments in 2000 reached US\$ 7 million.

Forestry and wood processing

Timber is Lithuania's most important natural resource. Around 30 per cent of the country is forested. The predominant trees are pine, spruce and birch. The timber industry has developed rapidly in recent years, spurred by rising world wood and paper prices and since 1991 output has more than doubled. The industry accounts for more than 15 per cent of the industrial share in GDP and the sector is highly export-oriented. Lithuania's sawmill output is more than 1 million cubic metres annually, but the woodworking industry has the capacity to produce more than 3 million cubic metres of raw material.

The sector comprises 40 large specialised companies and more than 3,000 small furniture factories and sawmills. Privatisation in the sector was completed at the end of 1994, when all enterprises became joint stock companies. Some of them retain some public capital, which is currently being sold to the private sector. Most companies have been amalgamated into two corporations: Lietuvos Mediena (comprising sawmills, building materials producers and wood-panel factories) and Furniture Producers Association Mede (combining furniture and woodworking companies). For many companies in the wood processing industry profits decreased in 2000 due to a drop in product prices and the low euro rate. An exception was Stora Enso Packaging, the Kaunas affiliate of the biggest European pulp and paper concern Stora Enso (Finland), which increased sales volume substantially in 2000 and now has 15 per cent of Lithuania's corrugated cardboard market.

The high value-added furniture industry did not see its profits drop in 2000. One third of all wood products exported from Lithuania are in the form of furniture. Russia was traditionally the main market for Lithuanian furniture, but the industry has rapidly increased its EU markets, especially in France, Germany, Denmark, Belgium, the UK, Austria and Spain. Now more than 48 per cent of exports are to the west and only 6 per cent to the CIS countries.

Kaunas-based holding company SBA, which owns a majority of shares in Lithuanian furniture producing companies such as JSC Klaipėdos Baldai, Silutes Baldai, Kauno Baldai, Kretingos Akmena and Kauno Karige, comprises about 20 per cent of the Lithuanian furniture market. SBA opened the most modern furniture centre in the Baltic states in October 2000. Investments into building and equipment amounted to nearly US\$ 2.5 million. The centre will mainly sell the furniture of its subsidiaries, such as Klaipėdos Baldai, Lithuania's leading furniture producer. Klaipėdos Baldai performed very well in 2000, increasing exports by 50 per cent, sales volume by more than one-third, and tripling its profits.

Vilniaus Baldu Kombinas (VBK) ranks second in the Lithuanian furniture market. Exports to the west account for 83 per cent of the company's turnover, with no exports to CIS countries. VBK made a profit in 2000 compared with a loss in 1999. A production and labour reorganisation helped to increase output and sales and had positive effects on the company results. Sales and exports doubled in 2000, and the company made about US\$ 1 million net profit, after suffering losses in 1999. The plant's products are marketed in foreign countries by Ikea (Sweden).

Oil

Mazeikių Nafta (MN) was formed by the merger of the Mazeikių oil refinery (12 million tonnes capacity), the new Butinge Nafta oil terminal which is connected by pipeline to the nearby refinery (8 million tonnes export capacity and 6.1 million tonnes import capacity), and Naftotiekis of Birzu (30 million tonnes crude oil capacity and 3.6 million tonnes oil products capacity) which operates the Birzu oil pipeline bringing Russian crude oil into Lithuania via the Russian Druzhba pipeline. MN is one of Lithuania's most important industrial assets. The refinery alone is estimated to account for around 10 per cent of GDP at full capacity.

In November 1999, a 33 per cent stake in MN was sold to a US strategic investor, Williams International, for US\$ 150

million (US\$ 75 million in cash to the company and US\$ 75 million by a promissory note payable in 2002). The privatisation of MN was subject to criticism over the non-transparent conditions of the sale. Apart from the US\$ 150 million payment by Williams International, the final terms involved a new government loan of US\$ 125 million to MN (in addition to an existing US\$ 177 million loan) and a government guarantee for a US\$ 75 million loan from Williams to MN. The government also promised guarantees for loans required for the capital expenditure programme. In addition, special benefits (concessions on taxes and railway tariffs and import tariff protection) were promised to the company. Only after the deal was signed, the loans and special benefits were disclosed under pressure from the IMF.

In October 2000 Lithuania's constitutional court objected to parts of the law approving the sale and giving Williams operational control of the refinery. The court paid particular attention to the part of the law which obliges the government to take on unspecified liabilities, and to the removal of minority shareholders' right to sell their stock to whom they want. The government has asked experts of English law to review the deal to find out whether changes to the original contract, which was drafted according to English law, are now needed.

MN reported losses, but almost doubled turnover in 2000. Williams invested LTL 80 million (US\$ 20 million) in MN in 2000. MN and Lukoil (Russia) are negotiating a five-year strategic cooperation plan on crude supply and marketing ventures in the Baltic states, Poland and the CIS. A joint task group of Williams International, MN and Lukoil was formed in February 2000 to devise the plan. The companies are negotiating a total of eight different agreements, including shareholder agreements for six joint ventures, a crude supply agreement, and an off-take agreement between MN and Lukoil Baltija.

The government has also privatised through an international tender an 81 per cent stake in the oil exploration and production company, Geonafta, which was sold to a Polish-Swiss-Lithuanian consortium, Naftos Gavyba, for LTL 52 million (US\$ 13 million).

Gas

The state owns 92 per cent of Lietuvos Dujos (Lithuanian Gas). Plans for the restructuring and privatisation of Lietuvos Dujos are advancing. A new law designed to regulate the industry following the liberalisation of the market on 1 July 2001 was

adopted in October 2000. Legislation on the sales of Lietuvos Dujos was also adopted in November 2000. The sale of between 34 and 51 per cent of the gas distribution monopoly is now under way. Two non-core units of Lietuvos Dujos were split off as joint stock companies, renamed Liquid Gas and Gas Equipment, to speed up the company's reorganisation before privatisation. There will be non-discriminatory access to the main pipeline and elimination of the monopoly in gas supply, with the State Price and Energy Control Commission responsible for the issuance of licences to suppliers. Following the appointment of an advisor, a privatisation tender was announced at the end of 2000, and applications are now awaited.

Energy

The Ministry of Economy is in charge of the electricity sector. The state owns 86.24 per cent of Lietuvos Energija (Lithuanian Energy). Lietuvos Energija operates all main conventional generating plants and the electricity transmission and distribution grid, with the exception of two large combined heat and power plants located in Vilnius and Kaunas, whose ownership was transferred to the municipalities in 1997 along with the district heating systems.

In May 2000, a law on the reorganisation of Lietuvos Energija was adopted. The law sets out the framework under which the company is to be restructured and privatised. In particular, the law specifies the ways in which different assets could be divided and the company unbundled. In June 2000, a privatisation advisor was appointed through an international tender with the aim to separate the electricity distribution network and two power generation facilities from Lietuvos Energija and to privatise the spin-offs.

In September 2000 the authorities endorsed a restructuring plan for Lietuvos Energija ahead of its privatisation. The plan envisaged the establishment of two generation companies, (Lietuvos Elektrine, the thermal power plant based in Elektrenai, and the Mazeikiai power plant) and two regional distribution companies (Rytu and Vakaru Skirstomieji Tinklai, respectively RST and VST, the Eastern and Western Distribution Networks). RST would cover distribution systems in Vilnius, Panevėžys, Alytus and Utena, and VST Kaunas, Klaipėda and Šiauliai. Lietuvos Energija would retain ownership of the transmission network as well as the Kruonis pump storage station and the Kaunas hydro facility after restructuring. Lietuvos Energija would also be responsible for regulating the energy system and for coordinating electricity exports, imports and transit.

The advisors to the government also called internationally for expressions of interest on the privatisation of the generation and distribution companies in September 2000.

After some uncertainty following the elections in the autumn, the Liberal Party-led coalition decided to continue its predecessor's policy, which relieved both the consortium advising the government and the 15 foreign companies which had expressed interest. The government even made the project one of the priorities in its 100-day action plan outlined soon after it took power in October. The restructuring and privatisation process resumed by February and is planned to be completed by the end of 2001.

A small portion (9.8 per cent) of Lietuvos Energija was floated on the stock exchange in 1999, and was bought by Vattenfall (Sweden), which was also invited to negotiate a lease agreement to supply district heating to Kaunas, renting the local grid from the municipal authorities. In November 2000, however, Vattenfall dropped its Lithuanian and Czech interests and transferred its east European assets to Eon (Germany).

Lithuania and Poland are involved in a project to link their electricity systems at an estimated cost of around US\$ 200-400 million. In October 2000 representatives of power grid operators Lietuvos Energija and Polskie Sieci Elektroenergetyczne, along with the countries' ministries of economy, formed a working group.

Ignalina

The bulk of Lithuania's electricity is generated by two nuclear reactors at the Ignalina nuclear power plant (INPP) with two RBMK 1500 type reactors. It generates 73 per cent of the country's electricity, with thermal plants supplying 21 per cent and hydroelectricity 6 per cent. Residential users account for around 26 per cent of energy consumption, industry for 47 per cent, agriculture 3 per cent and other consumers 24 per cent. Lithuania has a large excess power generating capacity. At the present time, 95 per cent of the installed thermal power generating capacity is available but it requires some investment to be brought back into full operation, and put in compliance with the European standards for environmental emissions.

Following approval of the National Energy Strategy and the Law on the decommissioning of Unit 1 of INPP by the Seimas in October 1999 and May 2000, the government developed a Decommissioning Programme for INPP Unit 1. This programme focuses on preparatory activities for the closure of Unit 1 before 2005 but also includes a number of early decommissioning projects for both Units 1 and 2.

Due to the age difference between Units 1 and 2, the conditions and precise date of the closure of Unit 2 shall be decided upon in the next National Energy Strategy (2004) when detailed information on the work of Unit 2 will be available. The Lithuanian government invited concerted and well coordinated national and international (bilateral and multilateral) effort, which should ensure the timely implementation of the programme.

On 12 June 2000 The EBRD's Board of Directors approved the rules and establishment of the three country specific International Decommissioning Support Funds (IDSF) for designated nuclear power plants in Bulgaria, Lithuania and Slovakia. These Funds were set up in close cooperation with the European Commission, which has mobilised the major contribution of the EU member states through the Phare funds. The international community responded to this initiative during the Vilnius Donors' Conference on 20-21 June 2000 with considerable pledges to the Ignalina Fund. The primary objective of the Ignalina Fund is to support INPP in preparing Units 1 and 2 for decommissioning during the period 2000-10, thus reducing the safety risk substantially following the phased closure of these Units. The Fund will also support consequential measures to facilitate the necessary restructuring, upgrading and modernisation of the energy production, transmission and distribution sectors, as well as improving energy efficiency.

Transport

Within the European integration process, Lithuania has devoted particular attention to the EU Transport Infrastructure Needs Assessment (TINA) programme. The main objective of this programme is to assess transport infrastructure needs in central European countries, identify projects of common European interest and define the future Trans-European Network (TEN) for transport within the enlarged EU. The existing TEN routes, all within present EU member countries, will be supplemented by the 10 so-called Pan-European Transport Corridors, which cross central and eastern Europe, creating transit routes for trade. Two of these Corridors cross Lithuania: north-south Corridor I, connecting Scandinavia with central Europe; and east-west Corridor IX, linking the east European markets with the rest of Europe. The TINA draft programme for Lithuania has been prepared up to 2015: it covers upgrading of 1,608 kilometres of roads, 1,173 kilometres of railways, the Port of Klaipeda and the airports at Vilnius, Kaunas and Palanga.

The transport sector has seen revenue fall across the board since the Russian crisis and has not yet fully recovered. Transit

trade stabilised in 2000, but local transport decreased. Railway cargo transit increased by 7 per cent. Bulk transit increased rapidly but container transit slowly. However, the official figures do not reflect the full extent of recovery, as there is evidence of unrecorded cross-border trade with the Kaliningrad region and Belarus. Avoiding the 100 per cent Russian import duties for foreign cars, for example, is very lucrative trade.

Roads

Aiming to rebuild its former role as a regional transport hub, road modernisation and construction have been a priority for Lithuania since the early 1990s. Since then, there has been a 46 per cent increase in roads and the country now has more than 71,000 kilometres. The three main highways are the E67, or Via Baltica, running across Lithuania from Tallinn to Warsaw (part of Corridor I), the E271 from Klaipeda to Minsk (Belarus) via Kaunas and Vilnius (part of Corridor IX), and the E272 between Vilnius, Ukmerge and Panevezys. The Via Baltica road project is being financed by the EIB, the EBRD, EU-Phare and the Nordic Investment Bank (NIB). In September 2000 the EU announced a US\$ 22 million package of support to projects on the second phase of the Via Baltica and modernisation of Corridor IX. The total budget for the Via Baltica project is US\$ 13 million and for the Vilnius-Klaipeda project US\$ 56.2 million.

Railways

Lithuania has 1,905 kilometres of railway track, of which 122 kilometres are electrified. In recent years railways have declined in importance both for passenger carriage and freight. The current railway network does not meet EU standards and does not connect with the TEN routes in terms of interoperability, as it is wide gauge. The system is in the process of being modernised. The most important routes are the east-west transit routes from Sumskas on the Belarussian border via Vilnius and Siauliai to Klaipeda Port and via Kaunas to Kaliningrad Port, and the additional TINA network line from Russia via Daugavpils (Latvia) to Siauliai.

A 90-kilometre European gauge railway is projected between the Polish border and Kaunas. This railway is part of Pan-European Transport Corridor I, linking Helsinki and Warsaw. The project will be financed with loans from IFIs and grants from the EU's ISPA fund (Instrument for Structural Policies for Pre-Accession). In November 2000, Lithuania and Poland launched a new direct rail passenger service between Warsaw and Vilnius, bypassing Belarus by using an automatic system to adapt rail cars to the different track gauges. Avoiding Belarus also allows passengers to obviate the need for a transit visa.

Lietuvos Gelezinkeliai (LG, Lithuanian Railways), the state-owned railway-company, is in the process of being restructured into different units for infrastructure and operational activities with the aim of becoming more competitive. Under the five-year restructuring programme, LG's operating activities will be divided into separate passenger transportation, cargo and other activities. The railway infrastructure will not be privatised.

The EBRD is considering a sovereign guaranteed loan of € 58 million to LG for the implementation of the restructuring programme and maintenance of railways. The project would be structured in cooperation with the ISPA fund, which is likely to provide parallel financing, and would be supported by EU-Phare technical cooperation funding. The main aims are to improve the competitiveness of Lithuania's main freight transit routes from the CIS to the Klaipeda and Kaliningrad ports, to enable LG to maintain the track effectively, and improve its productivity and financial position through corporate restructuring. The project would enhance transit trade between Russia and western Europe, stimulate competition for cost-effective freight transport, and encourage private sector involvement.

LG made a profit in 2000 as opposed to losses in 1999, following cuts in expenditures and other cost-efficiency measures. Income from freight transport was up, income from passenger transport down. However, the company owes money to the contractors for the work performed.

Ports and shipping

Klaipeda, Lithuania's largest port, is the northernmost ice-free outlet in the Baltic region. With road and rail connections to Belarus, Russia and Ukraine, it handles a significant part of Baltic Sea trade, although competition from Latvia's Ventspils and other Baltic ports is fierce. In 2000 Klaipeda emerged as the fastest growing port in the Baltic Sea in terms of freight turnover, with an increase of about 50 per cent over the previous year. Klaipeda is a multipurpose port, capable of handling more than 20 million tonnes of different types of cargo per year: metal and steel, oil products, timber, containers, refrigerated products, cereals, rail-wagons, trailers and cars.

Oil terminals

Based at Klaipeda Port, the **Klaipedos Nafta** oil terminal is able to handle 7 million tonnes of various oil products per year. On a rail-trestle 124 rail-tanks can be discharged/loaded simultaneously. Klaipedos Nafta is in the final phase of a US\$ 130 million terminal reconstruction, which was initiated several years ago. In 1994 a joint Lithuanian-US venture, Klaipedos Nafta, was founded, which

has been carrying out the reconstruction. The Dutch engineering company Tebodin was selected as the general contractor. ABN Amro bank (Netherlands) is the main creditor of the project. Klaipedos Nafta has already invested some US\$ 104 million in the project and has already become one of the most modern and attractive terminals in Europe.

Lithuania's new crude oil pipeline terminal at **Butinge**, 2 kilometres inland from the coast, has a capacity of 8 million tonnes per year. The Butinge terminal is part of the Mazeikiu Nafta concern and started operations in July 1999. In 2001 Butinge will increase its capacity with three new onshore reservoir tanks, allowing faster loading. The Butinge terminal aims to serve the Russian oil industry, though relations with Russian suppliers are still being developed.

Although Klaipeda Port itself is classified as "strategic", and thus has to remain in state hands, the surrounding storage and transport facilities have attracted considerable FDI. The port incorporates seven specialised stevedoring companies, three ship repair yards, a shipbuilding yard, freight forwarding and shipping agencies and other enterprises serving vessels, cargo and passengers. There are plans to turn the area into a free port. In September 2000 six laws were adopted regulating the free port status and expansion of Klaipeda Port, implemented from 1 October 2000.

Currently limited to bulk cargo vessels with a maximum of 40,000 tonnes and to tankers with a maximum of 60,000 tonnes, Klaipeda is being modernised to handle bulk carriers up to 60,000 tonnes and tankers of up to 90,000 tonnes. Dredging of the port waters down to 14 metres, reconstruction of the quay walls and rehabilitation of the harbour entrance are being carried out. A long-term port development investment programme should boost the port's annual output threefold over the next decade, when throughput of 60 million tonnes per year is expected. Some US\$ 125 million has been earmarked for investment in the port development in the coming years, with US\$ 25 million invested in the infrastructure each year until 2004. The programme is co-financed by IFIs. In September 2000 a € 10 million loan from the EIB was agreed which will be used for a pier reconstruction and railway network development project. The total project costs are estimated at US\$ 19.25 million, of which the EIB is financing 49 per cent and the authorities the remainder. The project is due to be completed in late 2002.

Klaipeda Stevedoring Company (KLASCO) is Lithuania's largest stevedoring company, handling more than half of the cargo

transported through Klaipeda Port. KLASCO consists of a general cargo port, an international ferry terminal and a container terminal, and has a capacity of 150,000 TEU per year. KLASCO handles the greatest amount of steel and other metals of all companies in the Baltic ports. KLASCO was privatised in 1999, when a local consortium led by Vialogas acquired 90 per cent of the company for US\$ 50 million. KLASCO is now in the process of restructuring. The company made profits in 2000 after losses in 1999.

LISCO

The Lithuanian Shipping Company (LISCO) operates both general cargo vessels and regular ferry lines. The ferry lines carry rail cars, automobiles and passengers between Klaipeda and Mukran (Germany) as well as cars and passengers between Klaipeda and Kiel (Germany), Arhus (Sweden) and Stockholm. LISCO employs about 1,400 people.

In July 2000, a tender for the long-awaited sale of a 79.97 per cent stake of LISCO was won by BB Bredo, a consortium of Dutch and Danish shipping companies, for US\$ 47.6 million. BB Bredo pledged to invest at least US\$ 76 million in the LISCO fleet, premises, ferry lines and tankers over the next three years. Some US\$ 55 million of the investment would have to be made within the first year. BB Bredo also planned to spin off the company's ro-ro ferry operations. The privatisation contract with BB Bredo was signed in October. However, following the objections of minority shareholders to aspects of BB Bredo's approach to the transaction, the deal could not be closed quickly due to disagreements on more detailed items. Currently the negotiations are being continued with only one partner in the consortium, DFDS (Denmark).

Aviation

Lithuania's main international airport is in Vilnius. In addition there are civil airports in Kaunas and Palanga, and a commercial airport in Siauliai. Lietuvos Avialinijos (Lithuanian Airlines, LAL) is still 100 per cent state-owned. LAL has recently modernised its fleet, which now consists of two Boeing 737-200s, one Boeing 737-300, two SAAB 340s and two SAAB 2000s. Lithuanian air companies carried about 20 per cent more passengers and 39 per cent more freight in 2000, but continued to record losses due to the weak euro and rising fuel prices. The earlier decision was to sell 49 per cent of LAL to a strategic investor and 5 per cent to the company's employees in 2000. This decision was changed in February 2001 to allow more flexibility in adjusting the share of the company available

for privatisation, depending on the requirements of the strategic investor, once identified. The company is now in the process of restructuring, its management has been changed, costs have been cut, revenues have increased, and it is now more attractive for a strategic partner.

Telecommunications

Telephone access is close to the regional average, with 300 telephone lines per 1,000 inhabitants. In accordance with the Telecommunications Development Programme, Lietuvos Telekomas (Lithuanian Telecom, or LT, the fixed-line monopoly operator) is raising teledensity to 400 per 1,000 inhabitants and increasing the number of computerised lines from 21 per cent in 2000 to 50 per cent in 2002. LT will hold the fixed-line monopoly until the end of 2002. From the start of 2003 the telecommunications law envisages full liberalisation of the telecoms markets, by which time tariffs must be rebalanced so that local calls are no longer subsidised by high long-distance rates.

LT was privatised in July 1998, when 60 per cent of its shares were sold to Amber Teleholdings, a consortium of Telia (Sweden) and Sonera (Finland) for US\$ 510 million, Lithuania's largest equity transaction to date. Amber's investment is scheduled to reach US\$ 221 million by July 2001. Another 5 per cent stake in LT was sold to employees. The remaining 35 per cent was to be sold in the second half of 2000. Under the terms of the deal with Amber Teleholdings, the government could not sell the rest of its shares until 7 July 2000, without the written approval of Amber. But with state finances under strain, the government was anxious to raise funds as quickly as possible and acquired approval from Telia and Sonera to bring the deadline forward. In June, a 25 per cent stake in LT was sold through a global IPO raising LTL 642 million (US\$ 160.5 million) despite the increasingly volatile market in technology stocks. This sale left the state with a 10 per cent residual holding.

LT continued to have good results in 2000, and reached the targets promised to investors at the time of the IPO. LT's LTL 12 million (US\$ 3 million) 10-year litas-denominated bond was 30 per cent over-subscribed, so the company is confident to issue more litas-denominated debts in the near future to cover currency exchange risks. LT has established a joint venture with Nexcom Telecommunications (US) to provide Internet-based telephony products. The companies plan to use voice-over IP technologies to offer a range of products, including Internet call-waiting, unified messaging and video conferencing.

Mobile telecommunication

In addition to fixed-line services, there are four licensed mobile networks, four pagers and six data-transfer services. The mobile phone market is growing rapidly and competition among the providers is fierce.

Omnitel is the oldest and largest GSM 900 operator. The network is owned by Amber Mobile Teleholdings. In September 2000 Omnitel awarded Motorola (US), one of its previous owners, a contract for the supply and deployment of General Packet Radio Service (GPRS) high-speed data solution. The service, developed by Motorola and Cisco Systems (US), was made available for Omnitel's clients in Vilnius in October and nationwide in early 2001. The high speed mobile data service delivers a wide range of Internet services to mobile devices and opens up the mobile market to a large number of data applications, including e-commerce, e-mail and data transfer. Omnitel launched its GPRS service with Motorola's Timeport 260 GPRS phones.

Bite GSM, 100 per cent owned by Tele Danmark, benefited from a € 45 million loan from the EIB in 1999 to expand its mobile network and establish data transmission and Internet networks. EIB investment now totals € 67 million. LT has sold its shares in Bite GSM.

Tele2 launched the latest DCS1800 network in December 1999. The owner is Levicom Cellular (Estonia), which itself is majority-owned by the Swedish telecommunications group NetCom. Tele2 now has about 8,000 subscribers.

Lithuanian telecom regulators announced a tender for a third GSM 900 network on 7 January 2000. The licence was to be issued at the end of March, but the existing GSM 900 operators launched a legal procedure, which delayed the awarding of the licence. Following these legal delays, the government reopened the tender in November 2000. Tele2 was declared the winner of the tender in early December, with mobile operator Radiolinja (Finland) in the second place.

The government has asked the transport ministry and the State Property Fund to prepare the sale of a third-generation mobile-phone licence, following on the heels of Latvia, which has opted for an auction. A pan-Baltic working group has examined the idea of offering one licence for all three Baltic countries to a single operator, but has advised against it.

Information Technology

International investors are showing growing interest in investing in advanced businesses in the Baltic region. In 2000, IT firms in Estonia, Latvia and Lithuania have enjoyed an unprecedented inflow of investments, about US\$ 50 million, originating mainly from investment funds. There are only six Baltic IT companies each worth more than US\$ 5.7 million, among which are Lithuanian firms Alna and Sonex, active in programming and software design.

Alna is the biggest Lithuanian IT company with a turnover of US\$ 27 million. The fast growing company, set up in 1989, doubled its turnover in 2000 and earns its revenues on software development and export. Alna, which currently exports mainly to Scandinavian countries, aims to consolidate its position on the German market. As an e-business solutions developer, Alna introduced programming services and systems for database administration at the Systems 2000 IT exhibition in Germany. In August 2000 Alna signed a US\$ 5 million export contract with software group Bentley Systems Inc (US) to design and produce software for Bentley's document management system Projectwise. In October Alna won a tender to design an information system strategy for gas utility Lietuvos Dujos. The Scandinavian Baltic Development Fund (SBDF) has taken a 10 per cent stake in Alna worth US\$ 1.4 million.

Sonex, established in 1991, writes and sells software, assembles computers and provides communications and other services. Sonex Grupe doubled its subsidiaries in 2000 from six to 12, including Sonex Computers, Sonex Systems, Sonex Distribution, Sonex Technical Maintenance and Sonex Training Centre. The company has been expanding into the Estonian and Latvian market and is now the only Baltic IT company active in all the three Baltic states. The group's consolidated turnover increased by about 40 per cent to US\$ 17.5 million in 2000. Sonex sold a new share issue, representing 33 per cent of its share capital, to the EBRD-sponsored Baltic Post Privatisation Fund (BPPF) for US\$ 2.75 million in June. The income derived from the sale allowed Sonex to improve its products, create new ones and enhance client service. The remaining 67 per cent of Sonex belong to the company's general director.

Sybase (US), a leading supplier of database software, is setting up a company in Lithuania to coordinate operations, sales and marketing. Sybase Baltic, the Finnish subsidiary of Sybase Inc, has set up separate units in Estonia and Latvia as well. Sybase aims to become the leading supplier of mobile and Internet solutions in the Baltic Sea region.

Retail

Retail trade recovered from its 1998-99 dip in 2000. Modern supermarkets and shopping centres are appearing all over Lithuania's urban landscape, slowly displacing the open-air markets and kiosks that characterised much of the retail trade. Vilniaus Prekyba opened the large and very popular Maxima supermarket near the Vilnius railway station in 1999. The Iki (Belgium) and Spar (Netherlands) chains have also been active. Iki recently opened a supermarket in the Vilnius Bus Station complex, a much needed boost to this part of the city. Ekovalda, a Lithuanian food retailer, opened its first Rimi supermarket in Vilnius in November 2000 and plans to rename all of its 13 stores Rimi in a year. Another new Rimi supermarket was opened at Klaipeda port at the end of 2000. Ekovalda controls about 10 per cent of Lithuania's retail food market and is 50 per cent owned by Ahold (Netherlands).

Baltic Food Holding (Sweden/Norway), a food retail and wholesale chain which has been rapidly expanding in the Baltics, in 2000 added 15 more shops to its already existing 65 shops and two wholesale companies in Estonia and Lithuania, provided by its distribution centre in Latvia. Main shareholders are Selvaag Gruppen (Norway), the Norwegian Government Regional Development Fund, Axfood AB (Sweden), and the managing director and the chairman of the board who set up Baltic Food Holding in 1995. Financing worth € 12.1 million from the EBRD is enabling Baltic Food Holding to develop its retail and wholesale activities in the Baltics by acquiring new supermarkets, upgrading its existing stores and expanding wholesale operations. The financing consists of € 6.6 million to Baltic Food Holding Estonia and a € 5.5 million equity investment in Baltic Food Holding AS, which is based in Norway.

Objekt-Entwicklung GmbH, a German real estate developer, is developing the Kaunas Shopping Centre. The centre will be the largest of its kind in Lithuania. The company's Lithuanian subsidiary, Baltic Shopping Centres, has leased 260,000 square metres of property near the Vilnius-Kaunas-Klaipeda motorway for 99 years and intends to invest DM 100 million in the project. The centre will have parking for up to 3,500 cars and 100,000 square metres of retail and entertainment space. Aside from regular retailers, the company will build space for a bowling alley, movie theatre and night-club. Another DM 100 million is to be invested by tenants.

Kauno Vandenys (Kaunas Water)

The Baltic Sea is the most polluted sea in Europe and its environmental problems have been the concern of the surrounding countries for the past 25 years. At the prime ministerial level in 1990 a declaration was adopted establishing the long-term objective of ensuring the ecological restoration of the Baltic Sea and the preservation of the ecological balance. During a ministerial conference of the Baltic Sea countries in April 1992 the Baltic Sea Action Programme was prepared and endorsed, developed as a response to the 1990 declaration. As part of the Action Programme the Baltic Sea's catchment area was thoroughly analysed and 132 environmental hot spots including 47 top priority ones were identified, of which five were in Lithuania.

Most cities in Lithuania discharge their waste water to the Baltic Sea through the Nemunas river and its tributaries, such as the Neris. Kaunas, the second largest city with a population of about 430,000, had no waste-water treatment at the time of the Action Programme, while it was estimated that about 90 per cent of the collected untreated waste water in Lithuania was discharged from Kaunas. Improving this situation was recognised as the top priority for the five environmental hot spots identified in Lithuania. The water utility in Kaunas is Kauno Vandenys (Kaunas Water Company, KW), established in 1995 as a special status joint-stock company, 100 per cent owned by the city of Kaunas.

As a direct result of the Action Programme, a 93.822 million Kaunas Water and Environment Project was set

up to enable KW to introduce waste-water treatment and to address urgent investment needs for the rehabilitation of existing water and sewerage infrastructure in Kaunas. The objectives of the operation were:

- to improve the environmental conditions in the Neris and Nemunas rivers, the Curonian lagoon and the Baltic Sea by introducing waste-water treatment in and expanding sewage collection from Kaunas;
- to improve water and waste water services and system efficiency through rehabilitation of priority networks and facilities;
- to enhance the operational and financial performance of KW into a more self-financing and self-managing enterprise;
- to pave the way for private sector involvement;
- and to introduce water conservation through more cost-based tariffs, increased metering and water leakage and wastage reduction programmes.

The total project cost of € 93.822 was financed by the Lithuanian government (54 per cent), the Kaunas municipality (8 per cent), tariff revenues (10 per cent), EU PHARE (5 per cent), a Swedish government grant (BITS, 4 per cent), a Finnish government grant (1 per cent), NEFCO (3 per cent), and the EBRD (15 per cent). The EBRD project was signed in 1995 and became effective in 1996. A sovereign guaranteed € 16.063 million EBRD loan was used to finance a waste-water treatment plant and goods (equipment, materials etc.) for the

rehabilitation of the main wellfields in Kaunas and of selected pumping stations for water distribution.

The waste-water treatment plant was inaugurated in September 1999. By the beginning of 2001, 70 per cent of the EBRD loan had been disbursed, 80 per cent of the work completed, and 16 out of 24 contracts completed. The project required tariff reform and a corporate partnership programme with the Stockholm Water Company. As a result of the project, KW was transformed into an autonomous, self-financing service enterprise with transparent financial and operational targets.

Further development of water services in Kaunas was identified as a priority for Lithuania in the EU accession process. KW and the city of Kaunas have applied to ISPA and the EBRD to co-finance a second phase of the Kaunas water and environment project. Phase II of the Kaunas Water and Environment Project would upgrade the waste-water treatment plant to provide secondary treatment, extend the waste-water network to connect remaining districts of Kaunas and upgrade the water treatment plant for iron removal. The EBRD is considering participation in the preparation and financing of Phase II of the project.

Financial sector



Lithuania's financial sector is further consolidating and is attracting considerable foreign investment. In late 2000 SEB (Sweden) completed its acquisition of Vilniaus Bankas, Lithuania's largest bank, creating a pan-Baltic banking group with direct interests in all three Baltic states. The two remaining large state-owned banks are in the process of privatisation, and a small state bank was privatised in 2000. The Lithuanian Telecom IPO boosted market capitalisation and trading volumes at the stock exchange (NSEL), which is further integrating in the Baltic and Nordic region. The non-life insurance market has been growing rapidly and has attracted considerable Nordic and German investment.

Banking sector

Private commercial banks were first established in Lithuania in January 1989. Most of the Lithuanian banks were shaken by the banking crisis of late 1995, which resulted in the tightening of supervision exercised by the Bank of Lithuania (the national bank) on the local banking system. The tougher regulatory environment proved beneficial and showed positive results during the 1998 Russian financial crisis. As Lithuanian banks had only limited exposure to Russian securities, the effects of the crisis were mostly felt by bank clients with substantial exports to the CIS.

Since the 1995 crisis, the Lithuanian banking sector has made substantial progress and has undergone continued consolidation. The number of banks has decreased from 28 in 1995 to 10 at the end of 2000, although room for consolidation still exists.

There are no highly specialised banks, and all commercial banks function as universal banks. Traditional operations are performed in retail banking. Banks open current and deposit accounts in local and foreign currencies for individuals, accept deposits and perform cash and checking operations. Loans granted by banks include consumer, housing and renovation loans. Tele-banking and electronic banking are becoming increasingly popular and the number of credit card holders is growing. Banking services are expanding and cover co-operative banking as well. Bank customers use documentary settlements and treasury operations. Banks have also set up specialised subsidiaries to offer banking related services such as leasing, brokerage and venture capital management, and investment management, which is likely to improve the overall results of Lithuanian banking groups in the near future.

Two of the 10 domestic banks are foreign bank subsidiaries set up by Hansapank (Estonia) and Parex Bank (Latvia), which acquired a controlling stake in JSC Industry Bank. There are three foreign bank branches, established by Kredyt Bank SA (Poland), Merita Bank (Finland), which took over the operations of the closing Vilnius branch of Societe Generale (France), and Norddeutsche Landesbank (Germany). Five representative offices of foreign banks and one specialised bank, Turto Bankas (governed by special law) are also operational in Lithuania. Turto Bankas is an asset management company set up by the government as a bad loan workout unit.

The merger in early 2000 of the two largest private commercial banks, Vilniaus Bankas and Bankas Hermis, most vividly displayed banking consolidation, creating the enlarged Vilniaus Bankas, the country's largest financial institution, second in terms of both assets and capital only to Hansapank (Estonia) in the Baltic states. Vilniaus Bankas controls nearly 42 per cent of the total assets of Lithuania's banking system.

In December 1998 Swedish banking group Skandinaviska Enskilda Banken (SEB) acquired its initial 32 per cent of Vilniaus Bankas's capital. SEB had already increased its stake in Vilniaus Bankas to 42 per cent by the time of the merger with Bankas Hermis. Through 2000, SEB continued to increase its stake in Vilniaus Bankas. In the last quarter it finalised its acquisition by raising its stake from 52.6 per cent to 97.9 per cent, as part of its strategy to create a pan-Baltic banking group with direct interests in Estonia (where it now holds 95 per cent of Eesti Uhispank), Latvia (98 per cent of Latvijas Unibanka), and Lithuania. SEB has spent about US\$ 210 million in total on its Lithuanian, Latvian and Estonian acquisitions to create the leading banking group in the Baltic states.

Banking privatisation

The second and third largest banks after Vilniaus Bankas are two majority state-owned banks: the Lithuanian Savings Bank (Lietuvos Taupomasis Bankas, LTB), and the Lithuanian Agricultural Bank (Lietuvos Zemes Ukio Bankas, LZUB). Together they account for almost half of total banking assets, but their market share is gradually declining. Each of them has a substantial market share and wide branch network. Following the recovery in local and international markets after the Russian crisis, the government renewed its commitment to proceed with the sale of these two banks to private investors.

Following the adoption of the Law on the Privatisation of the Lithuanian Agricultural Bank in March 1999, a partial privatisation of LZUB was organised by executing a swap of the state-owned shares of LZUB for the shares of Lithuanian Development Bank (LDB) owned by EBRD. Following the share swap, the EBRD acquired 11 per cent of the share capital of LZUB.

Until the end of 2000 LDB was governed by special law. The development bank had been established by the government jointly with the EBRD to finance private business sector projects in Lithuania. However, in 1999 the Law on the Lithuanian Development Bank was amended to allow revision of the bank's by-laws and its reorganisation into a commercial bank. In September 2000 the new by-laws came into force and a new banking licence was issued to the bank. Since then, LDB is a commercial bank and is allowed to carry out all banking operations except for operations with securities and trading in precious metals.

After the above mentioned share swap the government became the major shareholder in LDB with 59.26 per cent of the share capital. As the government had the intention to divest itself of ownership in the banking sector, in July 2000 LDB was scheduled for privatisation and in August a public tender was announced and a privatisation programme approved. The deadline for the bidders was 16 October. Both the government's and other shareholders' shares, totalling 100 per cent, were offered for sale. At the end of 2000, LDB was sold to the financial group Sampo Oy (Finland), comprising the

recently combined insurance business of Sampo and the banking activities of Leonia. Sampo acquired LDB for approximately LTL 41 million (US\$ 10.25 million). The purchase agreement was signed at the end of 2000. LDB was the first of the three state-owned banks to be successfully privatised in full.

At the beginning of 1999 LTB was included in the list of entities to be privatised and was scheduled for privatisation in mid-2000. In August 2000 a public tender was issued and the privatisation programme approved. Bids were due to be submitted by 2 October 2000. Hansapank, an Estonian bank which is itself 50.6 per cent owned by Swedbank (Sweden), was announced the winner of the public tender for LTB and was invited for negotiations which started in January 2001.

Privatisation of LZUB, which had been postponed due to the Russian crisis, moved forward in 2000. A new open tender for the privatisation was issued in April 2000, and bids for the sale of the 76.01 per cent share package were accepted until 15 May. The sole bidder was a consortium of Bank PeKaO SA (Poland) and UniCredito (Italy), the majority owner of Bank PeKaO SA. Negotiations between the government and the consortium were at an advanced stage when in November the consortium backed out of the deal, announcing that it would not participate in further negotiations on the acquisition of LZUB. This was the second unsuccessful attempt to privatise the bank, after an earlier attempt to privatise the bank was postponed due to the Russian financial crisis in 1998. Currently new privatisation plans are under preparation. Norddeutsche Landesbank (Germany) has announced that it plans to buy a stake in LZUB when the government relaunches the sale.

Foreign banks

There is an equal playing ground for the operations of both foreign bank branches and local banks. The number of foreign players in the sector has increased as foreign banks have set up their own subsidiaries and branches or acquired local banks. Acquisition of 10 per cent or more of the share capital requires approval by the Bank of Lithuania.

Foreign bank branches have continued to expand their banking operations but their share of banking system assets has remained

insignificant. As at 1 October 2000, their share of the total assets amounted to 3.1 per cent, the same level as at the beginning of the year. The share of foreign ownership, however, continued to grow. In October 2000, the share of foreign investors in the banking system had increased to 59.8 per cent due to changes in the ownership structure of certain banks.

Credit unions

As at 1 October 2000, there were 35 credit unions operating in the country, with assets comprising 0.1 per cent of banking system assets. The number of credit unions is steadily increasing: during the last quarter of 2000 the Bank of Lithuania issued three licences to newly established credit unions.

Non-bank financial institutions

Securities market

The main institutions shaping the Lithuanian capital markets are the Lithuanian Securities Commission (LSC), the National Stock Exchange of Lithuania (NSEL), and the Lithuanian Central Securities Depository (LCSD). They are regulated by the Law on Public Trading in Securities, adopted in 1996. Control over the market is exercised by the LSC. According to the Law on Public Trading in Securities, only financial brokerage firms and departments of commercial banks with permits from the LSC to operate in securities can act as intermediaries in public trading.

The regulatory framework for portfolio investment in Lithuania's securities market improved as a result of amendments to the Law on Public Trading in Securities in 1998. The amendments demand more comprehensive disclosure requirements for listed companies, provide sanctions against insider trading, streamline lists, and enhance the supervisory and sanctioning powers of the LSC. At the end of 2000, there were two A-category financial brokerage firms (FBFs), 17 B-category FBFs, four C-category FBFs and 10 specialised brokerage departments of commercial banks on the securities market, making a total of 43 intermediaries. Of these 43, 24 intermediaries in public trading have the right to trade on the NSEL. Financial brokerage firms operating in Lithuania meet the EU requirements for the minimum initial capital and capital adequacy. Nevertheless, Lithuania has to further

amend the current securities law to fully meet IOSCO standards and applicable EU directives. Planned amendments have already been prepared and issued to the relevant institutions for their consideration.

The NSEL is a corporation with 246 shareholders, with 44 per cent of capital held by the Ministry of Finance. Since 1998 the NSEL has been a correspondent of the International Federation of Stock Exchanges. On 8 June 2000 the NSEL received correspondent exchange status with the Federation of European Securities Exchanges. Total market capitalisation at the end of 2000 amounted to LTL 13.741 billion (US\$ 3.435 billion). Turnover totalled LTL 1.759 billion. Shares accounted for LTL 808.8 million (US\$ 202.2 million), while debt securities totalled LTL 950 million (US\$ 237.5 million).

The Lithuanian Telecom global IPO of June 2000 boosted market capitalisation and trading volumes. About one-quarter of the shares offered were sold in Lithuania, Latvia and Estonia and were listed on the NSEL. The IPO had a significant impact on market capitalisation and trading volumes on the NSEL. The capitalisation of listed shares rose by over 50 per cent, from LTL 4.18 billion (US\$ 1.045 billion) to LTL 6.64 billion (US\$ 1.66 billion). The daily trading volume also increased significantly. Major stocks at the NSEL include Lithuanian Telecom, Rokiskio Suris (dairy), Snaige (refrigerators), Ekranas, Vilniaus Vingis (both electronics), Lietuvos Energija (power), Linas (textiles), Lietuvos Juru Laivininkyste (ship transportation), Mazeikiu Nafta (oil), and Lietuvos Zemes Ukio Bankas (banking).

The small Lithuanian, Estonian and Latvian stock exchanges realised that regional co-operation would be the best way for them to attract capital. At the beginning of 2000 the three stock exchanges launched the Baltic list, intended to package and market shares in the 15 largest and most widely traded Baltic companies. In May the NSEL signed a letter of intent to join NOREX, the alliance of Scandinavian stock exchanges, as a fully-fledged member, although the exact timetable remains unclear. On 2 May 2000 the NSEL, together with the Riga and Tallinn stock exchanges, signed a letter of intent with the NOREX alliance, which outlines the principles of closer

co-operation and the preconditions for joining the NOREX alliance. The co-operation foresees full harmonisation of the Lithuanian capital market legal framework with Scandinavian legislation and EU directives. At present, the NOREX alliance only includes Sweden and Denmark, but the Norwegian and Icelandic stock exchanges plan to join in 2001.

Investment companies

In 2000, the first investment variable capital company was founded in Lithuania, which will invest into the 30 most liquid stocks on the NSEL. Twelve investment holding companies also operate in Lithuania.

Pension funds

In June 1999, the Seimas approved the law on pension funds, which came into force in January 2000. The law establishes the legal foundations for private voluntary pension funds and will pave the way for the eventual establishment of a multi-pillar pension system as indicated in government proposals issued in May 2000. Following the passage of the law on pension funds in June 1999, secondary legislation that governs the licensing and auditing procedures of private pension funds was drafted and is pending parliamentary consideration. The SC, which acts as the regulator for pension funds, has yet to provide licences. No commercial funds have been created.

Meanwhile, the pension system in Lithuania still remains the exclusive domain of the State Social Insurance Fund Board of Lithuania ("SODRA"), the state pay-as-you-go system. The introduction of private pension funds is particularly important as Sodra is in a precarious financial position, and its long-term viability is in question.

Insurance

Formation of the private insurance market in Lithuania started in 1991. On 10 July 1996 the Law on Insurance was passed. The Lithuanian insurance market has been growing at a fast pace, with a compound annual growth rate of over 30 per cent since 1995, as a result of both GDP growth and increased product awareness. In order to provide better protection for policyholders in line with EU directives, amendments to the insurance law were made and came into force in April 2000.

As at 1 January 2001, the number of licensed insurance companies operating in Lithuania was 33, of which 24 were non-life insurance companies, six life insurance companies and three credit insurance companies. The number of companies with foreign capital participation and foreign insurance companies active in Lithuania had reached 11. Foreign shareholders owned 37.25 per cent of the total equity of insurance companies. The number of insurance brokers operating in Lithuania is 71. Six insurance companies are either partly or totally owned by commercial banks.

It is expected that the insurance market in general will grow significantly over the coming years due to natural growth in the market. Compared to both western Europe and its Baltic neighbours, Lithuanian premium volumes as a percentage of GDP are lower. The main reason may be the fact that compulsory third-party liability insurance for vehicle owners has not been introduced as yet.

Lithuania's largest state-owned insurance company, Lietuvos Draudimas, was privatised in May 1999 when Codan (Denmark) acquired 70 per cent and pledged to invest another LTL 100 million (US\$ 25 million) over five years, of which it had already invested LTL 60 million (US\$ 15 million) by the end of 1999. Codan, majority-owned by Royal & Sun Alliance, later increased its holding in Lietuvos Draudimas to 78 per cent. Lietuvos Draudimas group accounts for 83 per cent of all life insurance premiums written in the country. Credit guarantee company Hermes Kreditversicherung (Germany) in early 2001 bought 49 per cent of the credit arm of Lietuvos Draudimas.

Leasing

The Lithuanian leasing market is composed of nine companies, with the four main ones holding a market share of over 90 per cent. As most of the companies are undercapitalised, the industry is expected to witness either a wave of consolidation or a series of capital increases. A strong capital base will also be required for the leasing companies to be able to access funding from international lenders.

The EBRD Baltic Business Advisory Service (BAS) Programme

The BAS Programme provides practical business advice to SMEs by implementing and managing clearly defined, short-term projects with rapid pay-back periods. It is funded by the Nordic countries Baltic Technical Assistance Special Fund (BTASF) and by EU Phare. The BAS Programme assists enterprises to remove barriers to growth and development, to enhance competitiveness and management effectiveness, and to prepare for EU accession. Qualified local consultants are used to the maximum extent possible. The BAS Programme currently works with 301 Baltic consultants, compared with 55 when the Programme started in 1995. Where the assignments are beyond the capabilities of local consultants, foreign consultants are contracted and in many cases twinned with local consultants to promote knowledge transfer. Up to 50 per cent (to a maximum of € 9,000) of the cost of each project is contributed by BAS, while the remaining cost is covered by each enterprise.

As at 31 December 2000, the BAS Programme had financed a total of 1,300 projects with 900 enterprises. Enterprise clients in total employ 98,000 and generate total revenues of € 3.6 billion. The programme now includes companies with less than 50 employees, the fastest growing business sector in terms of employment. This "micro-BAS" programme is also funded by the BTASF.

The EBRD TurnAround Management (TAM) Programme

The TAM Programme transfers management and technical know-how to enterprises in the EBRD's countries of operation, assisting these enterprises to develop the skills necessary to succeed and grow in free market economies.

The TAM Programme works directly with individual enterprises, advising each, as appropriate, on developing management skills, business planning, restructuring, improving products and reducing operating costs, meeting EU criteria for manufacturing and production, and on developing local and export markets. In the course of each project, particularly in the EU accession countries, TAM additionally advises on environmental impact, optimisation of energy and materials use, and on improvement of health and safety of employees at work. TAM also advises on how to access external investments and/or loans.

Enterprises selected for TAM projects have 300 to 3,000 employees (less than 300 when turnover is more than US\$ 2 million), and are engaged in manufacturing of industrial and consumer products, as well as in heavy industry, food processing and transportation. The TAM Programme sends a suitably qualified Senior Industrial Advisor (SIA), with long experience at top management level in the same industry sector, to work with the enterprise's management for about 30 days spread out over 12 to 18 months. The SIA also brings in one or more specialists to deal with particular functional areas such as MIS and marketing.

The impact of TAM in the Baltics is illustrated by the fact that the aggregated sales of the 164 Baltic enterprises with which TAM projects have been implemented, is US\$ 3.2 billion (i.e. about US\$ 20 million per enterprise on average), and 53 of these have been able to mobilise US\$ 448 million of external financing (investments and loans) during or after TAM assistance. TAM enterprises employ 132,000 people.



EBRD activities in Lithuania

As at 31 December 2000, the European Bank for Reconstruction and Development (EBRD) had signed 27 investments¹ in Lithuania totalling € 366.7 million. Four of the projects are in the public sector totalling € 98.4 million, two in transport and one each in water supply and energy.

Of the 23 private sector projects, 13 are in banking, including subordinated loans to strengthen the capital of local banks, credit lines to provide funding to local enterprises (including small and medium sized enterprises – SMEs) through local banks, and direct equity investments in banks. The other projects are in insurance, telecommunications, wood products, textiles, energy, food processing, fertilisers and insulation materials.

Under the Nuclear Safety Account, for which the EBRD acts as administrator, Lithuania has received grants of over € 43 million for short-term safety upgrades and an in-depth safety assessment at the Ignalina Nuclear Power Plant. The EBRD will also administer the International Decommissioning Support Fund for Ignalina.

Overview of EBRD activities and key objectives

The main operational objectives of the Bank in Lithuania are:

- **Supporting the restructuring, privatisation, and sound corporate governance of enterprises.** In the case of larger infrastructure-related enterprises, the Bank stands ready to provide pre-privatisation financing linked to restructuring, as well as to participate in privatisation or post-privatisation transactions alongside strategic investors. The Bank will provide direct financing to domestic enterprises in the agribusiness, industrial and service sectors, as these grow in size.
- **Continued support for SMEs.** For this purpose, the Bank will rely on the local banks, the regional equity funds and the Direct Investment Facility (DIF). In addition, the Bank will fund SMEs under the EU/EBRD SME Facility. The Bank will also support leasing companies. Turn Around Management and Business Advisory Services programmes will be further expanded.
- **Expanding support for the financial sector,** with a view to promoting the mobilisation of domestic savings and their efficient allocation to investments in the economy, supporting SME development, increasing competition, and furthering the development of local capital markets. The EBRD stands ready to further support the privatisation of the Agricultural Bank and will consider potential support for the privatisation of the Savings Bank. The EBRD is also

prepared to invest in pension funds and support the capital raising efforts of the successful regional Baltic States private equity funds which it helped establish.

- **Promoting restructuring, privatisation and participation by the private sector in the energy sector,** particularly in power/heat generation and district heating, electricity distribution, gas transmission, and through funding of energy services companies (ESCOs). Opportunities in other sectors will also be pursued and include projects which strengthen the key role of Lithuania in east-west trade (e.g. private sector port terminals, further commercialisation of railways in preparation for future privatisation/concessions arrangements), as well as municipal projects, including those linked to private sector participation and/or municipal credit enhancement.

Environmental considerations will continue to receive particular attention in the context of Bank-financed projects.

Signed projects as at 31 December 2000

Dalkia – Litesko

CGC Litesko is an ESCO financed under the Compagnie Générale de Chauffage ESCO Multi Project Facility (MPF). This MPF provides equity and debt financing in ESCOs to be established, acquired or expanded in central and eastern Europe and the Commonwealth of Independent States. The ESCOs will provide energy-saving services to clients in both the public and private sectors in the countries of investment.

Energy Sector Emergency Investment Project

In December 1992 the EBRD made a loan of € 36 million to address urgent problems in energy supply and to improve energy use efficiency. The project also started the process of improving the commercial basis of Lithuania's energy utilities by raising the standards of financial management. The project has had a significant impact on environmental performance. Technical assistance has been provided to help with the commercial re-orientation of the energy sector.

Sampo Bankas (formerly Lithuanian Development Bank)

In August 1994 the EBRD and the government of Lithuania signed an agreement to establish the Lithuanian Development Bank (LDB) with an initial share capital of € 5 million to provide

¹ Excluding projects funded by regional funds.

medium and long-term funds to Lithuanian private sector SMEs. The EBRD made a € 0.9 million equity investment in the bank. A further equity investment of € 0.7 million and an SME credit line of € 3.3 million were signed in 1996. In 1999 the EBRD swapped its € 1.6 million worth of shares in LDB for shares in the Agricultural Bank of Lithuania, thus effectively exiting from LDB equity. LDB was privatised late in 2000 and in January 2001, when its name changed to Sampo Bank.

Transport

In September 1994 the EBRD made a loan of US\$ 16.2 million to finance the improvement of rail services from Lithuania's eastern border to its Baltic Sea coast, to reduce the backlog of maintenance and to implement improvements on the major road network. The railway route is a vitally important international transit link, but had been falling into disrepair. The project involved replacement of about 131 kilometres of railway track, provision of track maintenance, resurfacing of major road networks, construction of a bypass, equipment for roads testing and surveys, and a study for the improvement of the port and rail transshipment connection at Klaipėda. The total project costs were US\$ 46.5 million, with US\$ 18.9 million to be contributed by the Export Import Bank of Japan.

A second transport loan of US\$ 23.2 million was signed in August 1996. The loan is part of a project which includes significant improvements to the Via Baltica in Lithuania and will be of benefit to international and local traffic. It aims at strengthening Lithuania's roads links with neighbouring countries and reducing delays at border crossings, by addressing problems of rapid deterioration in the east-west highway between Vilnius (the capital) and Klaipėda (the main port), financing completion of five bypasses, providing important new road links in the street network of Kaunas (the main industrial centre) and Vilnius, and improving road user pricing and road traffic safety. The total project cost is US\$ 117.1 million and also involves US\$ 11.1 million in co-financing from the Export Import Bank of Japan, US\$ 25.0 million from the European Investment Bank, US\$ 19.0 million from the International Bank for Reconstruction and Development (World Bank), US\$ 6.6 million from the Nordic Investment Bank and US\$ 2.0 million from EC Phare.

Telecommunications

In November 1994 the EBRD made a loan of US\$ 25 million to Lietuvos Telekomas (Lithuanian Telecommunications) to help Lithuania modernise and promote its telecommunications infrastructure and to support the restructuring of Telekomas.

The project was designed to provide direct lines to 14,000 new subscribers and to eliminate network congestion, in particular in Vilnius, Kaunas and Klaipėda. The financing covered the installation of a new international gateway, high-quality digital exchange lines, local call meters, implementation of a new computerised subscriber billing system, and an institutional development programme. Total project cost was € 49.3 million and involved co-financing of US\$ 10 million from the Export Import Bank of Japan.

In June 2000 the EBRD invested US\$ 49.6 million (€ 52.2 million) in a 7.7 per cent stake in Lietuvos Telekomas. The government sold 25 per cent of the company on both the London and Vilnius stock markets. The public offering was an essential element of the government's privatisation programme.

Vilniaus Bankas

In August 1995 the EBRD extended a credit line of € 7.1 million to Vilniaus Bankas (VB) to increase its medium- and long-term lending to the private sector. In August 1998 the EBRD provided VB with a DM 20 million subordinated loan, with a view to enabling VB to sustain its projected growth while retaining sound capital adequacy. This was followed in May 1999 by a syndicated facility of € 75 million jointly arranged by the EBRD and Bankgesellschaft Berlin AG. The financing comprised a five-year € 25 million loan for the EBRD's own account.

Vilniaus Bankas (formerly Bankas Hermis)

In 1995 the EBRD signed an equity investment of € 3.1 million and a € 7.6 million credit line to allow Bankas Hermis (BH) to increase its medium-term lending to the private sector and particularly to SMEs. Technical assistance has also been provided for institutional strengthening. In July 1998 the EBRD extended a DM 18 million convertible loan to Bankas Hermis. The project aimed to increase longer-term lending to private businesses and to strengthen new financial services introduced by BH. In early 2000 Bankas Hermis merged with Vilniaus Bankas and the EBRD exited from Bankas Hermis equity in the process.

Kaunas Water Company

In September 1995 the EBRD made a loan of US\$ 15 million to the Kaunas Water Company (KW) to improve the quality of water and waste-water services in Kaunas, Lithuania's second-largest city. The project aimed to enhance the operational and financial performance of KW through corporatisation, improved management and increased cost recovery. In addition, the

project helped to introduce water conservation through more cost-based tariffs, increased metering, and water leakage and wastage reduction programmes.

The total project cost was US\$ 73.1 million, with a major part of the financing provided by the Lithuanian government. Other financiers were EC Phare, the Finnish government, the Nordic Environment Finance Corporation and the Swedish International Development Cooperation Agency. The project will be of major benefit to the environment, and will provide a reliable water supply to domestic consumers and industry.

Paroc Silikatas Insulation Materials

In August 1995 the EBRD made a loan of SEK 55 million to Paroc Silikatas UAB (PS), a joint venture between Partek Insulation AB of Sweden, Silikatas UAB of Lithuania, Finnfund and the Nordic Environment Finance Corporation (Nefco). The joint venture had been established to produce high-quality rockwool insulation. As well as being shareholders, Finnfund and Nefco have also contributed to the project, which involved financing a modern production line, building work and working capital.

IO Fund

In 1997 an investment of DKK 1.8 million was made in a furniture manufacturing company under the Co-financing Facility with the IO Fund. In April 2000 the EBRD made an equity investment of € 7.4 million in Lithuania's largest insurance company, Lietuvos Draudimas, under the Co-financing Facility with the IO Fund.

Agricultural Bank

In August 1998, the EBRD together with Deutsche Investitions- und Entwicklungsgesellschaft GmbH (DEG) extended a DM 20 million subordinated loan facility to the state-owned Lietuvos Zemes Ukio Bankas (Agricultural Bank of Lithuania or AB). The increase in Agricultural Bank's capital base and liquidity allowed it to continue the reorganisation of its branch network and restructuring of operations ahead of its privatisation.

A stronger capital base also aimed at giving the bank an opportunity to make better use of its resources, increase its credibility among senior international lenders and extend its lending to local customers. Financing consisted of a DM 15 million loan from the EBRD and a parallel DM 5 million loan from DEG. The loans were structured so that both the EBRD and DEG can convert their debt into ordinary shares, subject to approval by AB's shareholders.

In December 1999, the EBRD and Raiffeisen Zentralbank (RZB) jointly syndicated a loan of US\$ 15 million to Agricultural Bank. The EBRD provided a five-year loan of US\$ 5 million for its own account, with the remainder provided by the co-financing banks. This was the first syndicated loan from international banks raised by the Agricultural Bank.

Siauliu Bankas

In December 2000 the EBRD agreed to finance a € 5 million credit line to Siauliu Bankas, a medium-sized bank. The credit line brings Lithuania into the EBRD's SME lending programme that is provided under the SME Finance Facility signed by the EBRD and the European Commission in April 1999. With a five-year maturity, the credit line will support the growth of the bank and will enable it to build a portfolio of good-quality medium-term loan assets. The proceeds of the loan will be used by the bank to provide micro loans (up to € 30,000) and small loans (up to € 125,000) to qualifying entrepreneurs and SMEs. EU Phare will finance a technical assistance programme for 18 months that will ensure effective implementation of the credit line, including training and technical support.

Rokiskio Suris

In May 1999 the EBRD made an equity investment of up to US\$ 11.5 million in AB Rokiskio Suris JSC (RS), the largest dairy processor in Lithuania. EBRD financing allowed RS to invest in additional modern cheese manufacturing equipment and to streamline its milk purchasing procedures. In addition, RS's sales and marketing programme are being strengthened to help the company further develop western, eastern and domestic markets for cheese.

Carlsberg MPF – Svyturys

In June 1999 the EBRD committed US\$ 9.6 million for a 19.9 per cent equity stake in Svyturys, the leading brewery in Lithuania. Through this project, Svyturys is implementing an enhanced sales, marketing and distribution structure and strengthen its management team. The investment was being made alongside two long-standing EBRD partners, Carlsberg and the Investment Fund for Central and Eastern Europe.

Drobe Wool

In April 2000 the EBRD and the IFC made a loan of US\$ 16.5 million (€ 17.0 million) to Drobe, one of the largest manufacturers of pure wool and wool blend fabrics in central and eastern Europe. The EBRD's financing consists of a US\$ 9.9 million loan and equity investment, of which US\$ 7.6 million will be provided from the EBRD's ordinary resources

and US\$ 2.3 million from the EBRD's Financial Intermediary Investment Special Fund. IFC's financing consists of a loan and equity investment totalling up to US\$ 6.6 million.

Lifosa

In September 2000 the EBRD made a loan commitment of US\$ 30 million to Lifosa, a manufacturer of phosphate-based fertilisers. A further US\$ 30 million is being sought through syndication to commercial participants. The project will improve the competitiveness of the fertiliser plant through greater economies of scale and efficiency gains, and will improve logistics by developing an import/export terminal at the port of Klaipėda.

Ignalina Nuclear Power Plant

In February 1994 a grant of € 34.8 million was made from the Nuclear Safety Account (NSA) for urgently needed short-term safety upgrades to the Ignalina Nuclear Power Plant. The NSA was established in 1993 at the request of the G-7. It was funded by 13 donor countries and the European Community, and is administered by the EBRD. Prepared in close cooperation with the G-24 Secretariat and bilateral assistance programmes, in particular with Sweden, the project is helping to implement a short-term Safety Improvement Programme by providing equipment for operational and technical safety improvements and by funding project management and engineering experts. An in-depth safety assessment has also been financed (€ 8.3 million).

Baltic states regional equity funds

Baltic Post-Privatisation Fund

The € 31 million Baltic Post-Privatisation Fund was launched in late 1996, initially as a separate country fund for Lithuania and for Latvia, and combined in mid-1998 to form a regional Baltic fund targeting private equity investments in Lithuania, Latvia and Estonia. The Fund's committed capital comprises € 30 million from the EBRD, in the form of a managed account, and € 1 million as a co-investment facility committed by the Fund manager.

The Fund is managed by Scandinavian Baltic Development Ltd, with offices in Vilnius, Riga and Tallinn. Talinvest Suprema is the Fund's local advisor. The Fund is targeting medium-sized manufacturing and service companies operating in the Baltic states that may require turnaround and restructuring, that may have difficulty in attracting long-term capital, and that offer attractive investment potential.

By the end of December 2000, the Fund had closed six investments for a total of € 16.6 million in Lithuania. The investee companies are among the leading players in the domestic textile, food processing and IT sectors. The Fund is expected to be fully invested by the end of 2001. The Fund owns a significant minority equity stake in each company, typically between 30 per cent and 40 per cent.

The Fund manager, supported by technical assistance funding provided by EU Phare, works with each investee company to restructure and expand the business. This is being achieved by strengthening corporate governance, improving cost control, and increasing sales and profitability. EU Phare also provides technical assistance funding to finance the Fund manager's "due diligence" on target investee companies.

Baltic Investment Fund

The Baltic Investment Fund (BIF) was established to undertake equity and equity-related investments primarily in medium-sized enterprises in Estonia, Latvia and Lithuania. The EBRD's commitment was for up to US\$ 6.25 million, with co-financing from the Baltic Investment Special Fund of up to US\$ 6.25 million, and for a total Fund size of US\$ 25 million. The purpose of the BIF is to support the growth of attractive privately-owned businesses in the Baltic states. A second transaction with similar objectives (BIF III LP) was signed in 2000 with an EBRD contribution of € 8 million, a € 5 million contribution from the Baltic Investment Special Fund, and for a total Fund size of € 45 million.

Baltic States Small Equity Fund

The Fund was set up in late 1997 to invest in SMEs in the three Baltic states, and its operation is based on a partnership between the Fund and the investee companies. The Fund takes a minority stake in the investee companies, with investments in the range of US\$ 25,000 – US\$ 400,000.

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**The
Country Promotion
Programme**

thanks

Taipei China

**The Taipei
Technical Cooperation
Fund**

United Kingdom

The Know How Fund

Switzerland

**The Swiss
Technical Cooperation
Fund**

Canada

**The Atlantic Council
of Canada**

Signed projects, as at 31 December 2000 (in € million), exchange rates as at 31 December 2000

Operation Name	Sector	Total costs	EBRD debt	EBRD equity	EBRD total
Private					
Dalkia - Litesko	Energy	15.8	7.4	1.0	8.4
IO Fund - Wood Team Production	Wood products	0.3	0	0.3	0.3
IO Fund - Lietuvos Draudimas	Finance	7.9	0	8.2	8.2
Lithuanian Development Bank Credit Line	Finance	7.0	3.5	0	3.5
Lithuanian Development Bank Capital Increase	Finance	5.8	0	0.7	0.7
Lithuanian Development Bank Capital Investment	Finance	5.0	0	0.9	0.9
Bankas Hermis Subordinated Convertible Loan	Finance	9.2	9.2	0	9.2
Bankas Hermis (Credit Line)	Finance	8.2	8.2	0	8.2
Bankas Hermis (Equity Investment)	Finance	3.4	0	2.6	2.6
Vilniaus Bankas	Finance	75.0	25.0	0	25.0
Vilniaus Bankas Subordinated Loan	Finance	10.2	10.2	0	10.2
Vilniaus Bankas (SME Credit Line)	Finance	11.4	7.2	0	7.2
Agricultural Bank Subordinated Loan	Finance	10.2	7.7	0	7.7
Agricultural Bank Syndicated Loan	Finance	16.1	5.4	0	5.4
LDB/LZUB Share Swap	Finance	4.8	0	1.6	1.6
Siauliu Bankas SME loan	Finance	5.0	0	5.0	5.0
Baltic PPF-Vilkma	Textiles	1.0	0	0.7	0.7
Baltic PPF-Trinyciai	Textiles	2.3	1.1	0.9	2.0
Baltic PPF-Kauno Pieno Centras	Agribusiness	9.4	0	8.1	8.1
Baltic PPF-Utenos Trikotazas	Textiles	4.5	0	3.9	3.9
Baltic PPF-Sonex	Services	1.6	0	1.6	1.6
Baltic PPF-Alna	Services	1.6	0	1.5	1.5
Rokiskio Suris	Agribusiness	15.0	0	12.4	12.4
Carlsberg MPF - Svyturys	Agribusiness	50.9	0	9.5	9.5
Lifosa	Fertilisers	86.0	32.2	0	32.2
Telecom Development International	Telecommunications	53.1	26.9	0	26.9
Lietuvos Telekomas IPO	Telecommunications	365.8	0	51.8	51.8
Drobe	Textiles	22.9	7.1	1.1	8.2
Paroc Silikatas	Construction materials	17.7	5.4	0	5.4
Private sub-total		827.1	156.5	111.8	268.3
Public					
Via Baltica and Lithuania Road Project	Transport	125.8	24.9	0	24.9
Kaunas Environment	Municipal infrastructure	93.8	16.1	0	16.1
Transport Sector Project	Transport	50.0	20.3	0	20.3
Energy Sector Emergency Investment	Energy	38.0	37.1	0	37.1
Public sub-total		307.6	98.4	0	98.4
Total		1134.7	254.9	111.8	366.7
of which private					73%
of which public					27%

Notes